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On the ground

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Politics this week

Nov 29th 2001
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Bonding in Bonn

At a meeting in Bonn called by the United Nations, rival Afghan factions broadly agreed on the shape of an **interim government** for Afghanistan. They settled on a council of 42 members, including both the Northern Alliance and supporters of ex-king Mohammed Zahir Shah.

See article: Everybody in

The United States deployed more than **1,000 marines** in Afghanistan to set up a forward base south of Kandahar, the only remaining city under Taliban control.

Reuters

See article: On the ground

Human-rights groups called for an inquiry in to the **killing** of hundreds of captured Taliban fighters in a fort near Mazar-i-Sharif.

See article: Reports of prisoner massacres

Bomb scare

Norman Mineta, the United States' transport secretary, admitted that his department could not meet a January deadline to **screen for bombs** the 3m bags checked in daily at American airports. He blamed a shortage of people, equipment and sniffer dogs.

A Massachusetts-based company, Advanced Cell Technology, said it had succeeded in **cloning a human embryo**. It stressed it simply wanted to advance medicine. George Bush called the achievement “bad public policy and morally wrong”.

See article: Ethics and biotechnology, continued

As Congress continued to squabble about a fiscal stimulus package, Mitchell Daniels, the White House's budget director, admitted that the federal government is likely to run **budget deficits** for the rest of Mr Bush's term. Doubts also increased about the chances of Mr Bush securing “fast-track” trade negotiating authority from Congress.

See article: The battles over the budget and fast-track

Falling apart

An official study confirmed what every patient knew, that **Britain's national health service** is underfinanced and falling apart. The government, in power since 1997, promised a sack of extra money for it.

See article: Labour's plans on taxes and spending

Under pressure from Jacques Chirac at a summit in France, Italy's prime minister, Silvio Berlusconi, refused to sweep aside his government's doubts about buying the proposed **Airbus A400M** military transporter, seen by some (notably its builders) as crucial to the credibility of the EU's would-be rapid-reaction force.

After years of playing good guy, **Denmark** plans to slim its foreign-aid budget. Its new prime minister, Anders Fogh Rasmussen, who took office on November 27th, said his centre-right government would also reduce immigration, do more to help newcomers find jobs and integrate with Danish society, and, among other things, raise the speed limit on motorways from 110kph to 130kph.

Spain's central government and that of its Basque region failed to agree on the renewal of the 20-year-old accord that governs their financial relations. The region runs its own tax system, and its Basque-nationalist government wants a place of its own at EU meetings handling matters that concern it. No, said Madrid.

Iraq under fire

Saddam Hussein rejected a call by George Bush for UN weapons inspectors to be allowed back into **Iraq**. American aircraft attacked targets in southern Iraq for the first time since the start of the air campaign against Afghanistan.

A demonstration by **Zimbabwean students**, protesting at the murder of one of their fellows, was broken up by police. Several pro-democracy activists were arrested when they protested at a proposed change to the country's electoral laws. A request by a European Union delegation which asked to be allowed to send observers to next year's election was eventually given approval.

South Africa's ruling African National Congress agreed that the New National Party, which in an earlier incarnation ruled during the apartheid years, should again play a (small) part in government.

See article: South Africa's Nationalists back in government

In the **Central African Republic**, rebels loyal to a former army chief, General François Bozize, briefly seized two towns before being forced back by CAR troops backed by Libyan forces. President Ange-Félix Patassé promised to take part in talks in Sudan on his country's stability.

Against a background of continuing violence, including the Palestinian killing of three Israeli civilians, **William Burns** and **Anthony Zinni**, America's two special envoys, set about trying to arrange an Israeli-Palestinian ceasefire.

EPA

See article: Hizbullah

Somalia's prime minister, Hassan Abshir Farah, told the United States that American troops would be welcome if they wanted to search for terrorists. But Mr Abshir's control is, at best, limited. America froze the assets of al-Barakat, Somalia's largest company.

Guerrilla deal

Muslim guerrillas in the southern Philippines freed 110 **hostages** they were holding for ransom. In a deal with the Philippine army, the guerrillas were given safe passage and kept their weapons. In a separate incident, the guerrillas' leader, Nur Misuari, was arrested in Malaysia.

Nepal declared a state of emergency after 100 people died when Maoist rebels attacked police and army posts.

See article: Nepal's insurgency

AP

Tommy Suharto, the youngest son of the former Indonesian president, was arrested in connection with the death of a judge who had earlier convicted him

of corruption.

Seven members of the **Falun Gong**, a spiritual movement banned in China, have died recently in Chinese jails as a result of ill-treatment, according to a support group in the United States.

Party promises

In a presidential election in **Honduras**, Ricardo Maduro, a businessman from the National Party, defeated the candidate of the ruling Liberal Party. Mr Maduro promised he would crack down on crime and push ahead with privatisation.

See article: Honduras's surprising election

Leaders from 21 Latin American countries and Spain and Portugal pledged to fight “terrorism in all its forms” at an **Ibero-American summit** in Peru.

A glimmer of hope for peace in **Colombia**: the government agreed to restart talks this month with the ELN, the smaller of the two main guerrilla groups.

President Vicente Fox of **Mexico** said he would appoint a special prosecutor to investigate the forced “disappearance” of hundreds of left-wing activists in the 1970s and 1980s.

See article: A year of Mexico's Fox

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Business this week

Nov 29th 2001
From The Economist print edition

Out of energy

The planned takeover of **Enron** by **Dynegy** collapsed after Dynegy pulled out, accusing its rival Texan oil-trading giant of misleading it. Earlier Standard & Poor's, a credit-rating agency, had downgraded Enron's debt to junk status. American regulators remain fretful about the impact of a probable collapse of Enron on financial markets.

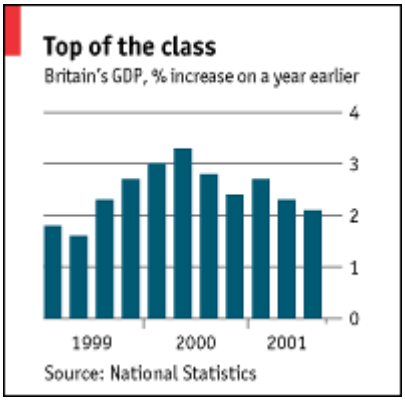
See article: Upended

America's **recession** is now official. The National Bureau of Economic Research said it had begun in March, ending the longest expansion of the economy on record. The current recession is unusual: employment has not so far fallen dramatically and real incomes have not yet declined at all.

See article: Say “R”

Gordon Brown, Britain's chancellor of the exchequer, is confident the **British economy** will be less affected by the global recession than its G7 peers. In periods of global economic slowdown in the past, Britain's economy suffered more than most. But Mr Brown predicted 2-2.5% growth next year and even faster growth in 2003.

See article: Pushing the boat out



European Union governments are proposing to scrap extra fees for credit-card payments and cash withdrawals of up to *euro*12,500 ($11,000) by July 1st 2002, and for **cross-border money transfers** in the same value range a year later.

New broom

Josef Ackermann, who is to head **Deutsche Bank** in six months' time, is planning to shake up the bank's cosy management traditions. But Mr Ackermann dismissed rumours that Rolf Breuer, Deutsche's current head, would leave the bank earlier than next May. Mr Breuer has been under fire ever since Deutsche's merger with Dresdner Bank, its arch-rival, collapsed last year.

Standard Chartered, a mainly emerging-markets bank listed in Britain, ousted its chief executive, Rana Talwar. The news increased speculation that the bank might be a takeover target, with both Barclays and Lloyds TSB talked of as suitors. Standard denies any discussions on a sale. Any potential buyer would have to win agreement from Khoo Teck Puat, a Malaysian who is the bank's biggest shareholder.

Michel David-Weill, chairman of **Lazard**, an investment bank, is trying to stem the exodus of the bank's senior executives by letting the bank's 140 or so working partners have a stake in the franchise.

Mitsubishi Tokyo Financial Group (MTFG) reported an interim loss, but it is still the only one of Japan's top four banks to expect a profit for the past year. Against the backdrop of a stagnating economy and an increase in corporate bankruptcies, the bank's three peers bolstered their provisions for loan losses. MTFG announced up to 4,500 job cuts by March 2005.

Lloyd's of London, the insurance market, is facing far bigger losses from

terrorist attacks on September 11th than it had first predicted. It now estimates its net losses (ie, losses after reinsurance) to be £1.9 billion ($2.7 billion), about £600m more than originally forecast. The biggest loss in Lloyd's 300-year history hit just when the market appeared to have turned the corner after root-and-branch reforms.

Reuters

Kvaerner, an Anglo-Norwegian engineering giant, agreed to merge with another Norwegian firm, Aker Maritime. By doing so, Kvaerner has staved off bankruptcy as well as thwarting a rival takeover bid from Yukos, a Russian oil giant.

See article: Kvaerner's emergency merger

Warning signs

BAE Systems, a British aerospace and defence group, issued its second profits warning of the year. It is shutting down its regional-jet manufacturing operation and will be cutting 1,669 jobs.

British Telecommunications will receive £2.38 billion ($3.4 billion) from the sale of most of its property portfolio to Telereal, a joint venture of Land Securities and the Pears Group. The portfolio includes offices, warehouses, telephone exchanges, call and computer centres, but not the BT tower and the BT centre in London. The deal, Britain's largest corporate property outsourcing to date, is meant to ease BT's debt burden.

Consolidation in Europe's retail market continued as **Kingfisher** and **Dixons**, two British retailers, made inroads into the German and Italian markets, respectively. Kingfisher bought 25% of Hornbach, a German do-it-yourself chain. Dixons, Britain's leading electrical retailer, took over 24% of Italy's UniEuro, and secured an option to buy all of UniEuro by 2003.

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The next phase

On the ground

Nov 29th 2001
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Gains in Afghanistan, losses in the battle of ideas

Get article background

Getty images

FROM the halls of Montezuma to the shores of Tripoli—and now to the dust of Kandahar: the deployment of American marines in Afghanistan this week proves more powerfully than all the supposedly epochal utterances made since September 11th that the United States is both serious about its campaign against al-Qaeda and well on the way to winning it. There can be little doubt now that the Taliban will be driven from their last significant outpost of Kandahar, leaving no large centres of population under their control. And as Taliban militants have been slaughtered by their Northern Alliance enemies this week, or have sheepishly surrendered or defected, so the idea of glorious defeat at the hands of the infidels has come to seem less compelling. No cries of sympathetic outrage have come from the Muslim world. Instead, the expressions of delight on the faces of ordinary Afghans, and the tales of life under the rebarbative Taliban, have offered eloquent justification for calling the downfall of the regime a liberation. American might will undoubtedly triumph.

The arrival of the marines also has a wider significance. For the first time since the Gulf war, American troops are in a foreign land, not guarding an embassy, protecting aid workers or trying to keep a peace, but fighting an enemy. American forces have already suffered casualties, and more may well follow, even though the marines will not take part in an offensive against Kandahar. Here then is an end to ten years of doubt about the United States' involvement in any form of combat that might lead to the shedding of American blood. To be body-bag averse is far from shameful: no one should relish unnecessary casualties, and technology now enables Americans to do much of their fighting from a height or a distance in comparative safety. But air strikes alone do not win wars; they need to be complemented with fighting on the ground, and an attack against America like that of September 11th has removed any hesitancy about the need to risk ground troops' lives in a military response.

That may lead to a welcome reassessment of the “Powell doctrine”, the credo enunciated by the secretary of state, Colin Powell, a few years ago which holds that America should intervene only when it has both overwhelming force and an exit strategy, an unduly cautious principle for a benign superpower. More important, it should dispel the belief, held by Osama bin Laden but not only by him, that the United States prefers to cut and run in the face of a terrorist attack in the Middle East. Under George Bush, the United States' instincts may be unilateralist but they are certainly not isolationist.

No celebrations yet

If events are turning America's way, however, they still have some way to go before real satisfaction can take hold. The main outstanding problem is that of finding Mr bin Laden and his associates, more vulnerable now to American search-and-destroy operations but still very much at large. Then comes the matter of finding a government, even an interim affair, to run the new Afghanistan. Four of the interested parties have been meeting under the UN's auspices in Germany this week, and the early signs have been encouraging. But no one is forgetting the Northern Alliance's hasty grab for Kabul last month, nor the rivalry latent among its members, never mind the fears of Pushtuns and other minorities who mistrust it.

Until a government with some authority is in place, it will be difficult to mount an effective aid operation, essential as that already is. The question of an international force to protect the aid agencies, and perhaps the people of Afghanistan, from feuding or rapacious warlords will also remain open. Who will command, indeed who will contribute troops to, an international force, if the country is without a plausible government? Not the United States, for sure.

The awkward balance

So things can still go wrong for Mr Bush. One large difficulty concerns the very ideals for which America is fighting: freedom, justice and the rule of law. The struggle against the kind of terrorism of which al-Qaeda has shown itself capable—terrorism involving the murder of thousands of innocent people, perhaps with nuclear, chemical or biological weapons—calls for extraordinary measures. The balance between civil liberties on the one hand and the reasonable demands of the state in defence of its citizens on the other has plainly shifted since September 11th. But how far? Tip it not at all and the risk is that terrorists will succeed in striking again, and perhaps even more destructively. Tip it too far and the risk is that the terrorists are unwittingly handed a victory.

Two worries have already emerged. One follows the words of Donald Rumsfeld, the defence secretary, when he said America was not in a position to take prisoners of war and, at the same time, that he hoped foreign recruits to the Taliban's side would not be allowed to return home. This came horribly close to an invitation to kill even surrendering combatants, a practice long forbidden by the rules of war. Lawyers may argue about the nature of this “war”, whether it is civil or international, whether foreigners are mercenaries or regulars, and whether those who fight for al-Qaeda and the Taliban are soldiers or mere terrorists. But the killing of prisoners, however nasty they may be, breaks a cardinal principle of warfare.

A similar concern surrounds Mr Bush's proclaimed intention to try foreigners suspected of terrorism in military courts. The difficulties of holding a conventional jury trial should not be dismissed. But secret tribunals requiring only low standards of proof, without a jury, in which the defendant may not have a voice in choosing his lawyer nor even hear all the evidence against him before being sentenced to death, are deeply disturbing. They risk not only the conviction of innocent defendants but also the alienation of some of Mr Bush's partners in the struggle against terrorism. Some European authorities are already balking at extraditing suspects to America if they are to face such courts. When so much is going so well for the United States, and deservedly so, it would be foolish to hand Mr bin Laden such an unnecessary gift.

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Europe and the euro

One currency, too many markets

Nov 29th 2001
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Europe must liberalise faster if it is to reap the full benefits of the euro

Reuters

THE world's focus has, understandably, been elsewhere. Yet a historic moment in Europe is fast approaching. In four weeks' time, Europe's single currency, the euro, will assume physical form. The 12 countries that are in the euro area will rapidly see their francs, marks and lire disappear, to be replaced by billions of depressingly bland euro notes and coins.

That may sound like small change (though not that small: if all euro notes were placed end-to-end, they would stretch five times the distance from the earth to the moon). The euro has, after all, been used in company accounts and traded in financial markets and on foreign exchanges for almost three years. Yet many firms, retailers and consumers have continued to do business in national currencies: for them, the euro has been only an ethereal phantom. From January 1st, it will become a reality, with all prices and transactions in euros. The political and economic impact will be huge.

The shape of things to come

Politically, the physical arrival of the euro is surely a big step towards a more fully integrated European Union—whatever protestations to the contrary Britain's out-but-would-be-in Tony Blair may make. But the precise shape of that more integrated Union will remain unclear for some time, as national governments engage in yet another round of constitutional discussions and, perhaps even more important, prepare to admit new members from the east. In the short run, therefore, it is the effects of the euro on economies and on businesses in Europe that will be more significant.

When the euro was conceived a decade ago, there was much heady talk of how it would boost competition in Europe, of all the structural reforms it would promote, even of how Europe would displace America as the world's economic dynamo. Yet, as a recent report by the European Commission concluded, the gap between Europe and America in both productivity and GDP per head has widened rather than narrowed over the past decade. This year's theory that, thanks to the euro, Europe would largely escape the effect of a global recession has also proved false, as its biggest economy, Germany, has shuddered to a halt. As if to trumpet Europe's failings, the euro has spent most of its first three years of ethereal life testing new lows against the dollar.

Much of the blame for this has been flung at the European Central Bank. The ECB's president, Wim Duisenberg, has certainly mishandled his communication with the markets; and it is at least arguable that the ECB has been too slow to cut interest rates this year. But it was justifiably anxious to demonstrate its tough-mindedness and independence from Europe's interfering politicians. Overall, it has done reasonably well. So, indeed, have most euro economies, partly because a weakish currency has helped them. On average, for example, the euro area has grown faster than Britain over the three years 1998-2001. But the performance of the core economies, especially Germany and Italy, is still miserable; and Europe's lamentably high unemployment is starting to climb again.

If not with the ECB, then, where should the blame lie for what threatens to be a renewed bout of euro-sclerosis? The answer is with Europe's governments. As our survey of business and the euro in this week's issue argues, the arrival of the physical euro will help to shape up Europe's companies by subjecting them to much easier price comparisons and more intense cross-border rivalry. The trouble is

that governments, meanwhile, are maintaining other barriers to competition.

It is not as if Europe's political leaders were unaware of this. At a summit nearly two years ago in Lisbon, heads of government committed themselves to a programme of further liberalisation and to the removal of most remaining barriers to Europe's single market, with the declared aim of making Europe the world's most competitive economy by 2010. The European Commission in Brussels has duly proposed a raft of directives and other measures. The trouble has been that governments have not delivered on their promises.

This year's roll-call of failure is especially depressing. France has implemented only minimal energy liberalisation and blocked the setting of any deadline for a total opening-up of the market. Full competition in postal services has been delayed. Germany first shot down an EU takeover directive that had been 12 years in the making and then introduced new rules that protect bosses at home. Procedural wrangles with the European Parliament have so far scuppered the Lamfalussy plan to free wholesale financial services, even though it was unanimously endorsed at a summit in Stockholm in March. Labour-market deregulation has proceeded at a snail's pace, or not at all. Attempts to agree upon an EU-wide patent regime have fallen foul of linguistic politics.

New vision, old ways

What has gone wrong? One answer is old-fashioned protection of producer interests. Germany's volte-face on takeovers was a concession to domestic companies' fear of more hostile foreign bids, such as Vodafone's for Mannesmann. French stalling on energy liberalisation has been designed to bolster its aggressive state-owned giant, Electricité de France, which is busy buying into other countries' more open markets. But the other answer is that many governments remain sceptical about the benefits of liberalisation, and fearful that it will end up destroying Europe's vaunted social model.

They are wrong, on both counts. There is a clear correlation between fuller telecoms liberalisation and lower telecoms prices, for example—which has translated into more Internet connections and faster-growing technology industries. And places such as the Netherlands and Scandinavia have shown that liberalisation, labour-market reform and high employment can go hand-in-hand with generous social protection. Next March, the incoming Spanish EU presidency will hold a summit in Barcelona to further the Lisbon agenda. It falls unhelpfully close to the French elections. But if Europe wants the euro to deliver its promised benefits, the Barcelona summit must produce results, not just more empty rhetoric.

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Britain's fiscal policy

Cash is no cure

Nov 29th 2001
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Labour is wrong to spend more money on the health service without also reforming it

IF YOU have to give them bad news, give it to them when they're feeling good. The war against the Taliban may seem a long way away from Gordon Brown's pre-budget report, but the government's popularity makes this a good time to hit the public with tax increases. So, in his speech to parliament on November 27th, the chancellor of the exchequer made it clear that he was abandoning his famous parsimony in favour of higher spending, particularly on health.

That, anyway, is how Mr Brown's spin-doctors explained it. The reality is a little more nuanced. Taxes have actually been rising for some time, in a big if unobtrusive way: the tax take has risen by 2.6% of GDP since Labour came to power in 1997. The National Health Service's needs may have been described starkly in a report commissioned by the Treasury and presented to parliament along with the spending plans, but they are hardly news. And the government's ambitions to improve public services were in any case expected to lead to further tax increases.

Still, even if the pre-budget report does not signal a sudden reversal of policy, it moves the government more briskly along the route that it had already started down. Given that Mr Brown has spent the past five years shedding Labour's old reputation for profligacy, this new acceleration is dangerous.

There are good reasons why Britain should spend a higher proportion of its GDP on health. The health service is operating at pretty close to capacity. Compared with other rich countries, Britain spends relatively little on health. Opinion polls, focus groups, taxi drivers—all the usual measures of public opinion that politicians and journalists rely on—suggest that people are prepared to pay more of their earnings in tax to get a better health service.

But even if more health spending is necessary for a better health service, money by itself will not ensure that the service improves very much, or at all. If a system is designed to fail, it is possible to pour in almost limitless amounts of cash without getting more or better services out of it. With luck, the extra funding that the government promises will increase the system's capacity—but, without bold reforms as well, that capacity will not be properly used.

The health service, already Europe's biggest employer, is a huge, centrally directed, Soviet-style bureaucracy. In the 1990s the Conservatives introduced some competition and devolved some power. That was a modest enough start—and Labour, in part, reversed it. Now, recognising the need to make the system work better, the government is trying to introduce some change at the margin. It is all too feeble. Making real changes to the way the NHS works would involve confronting public-service unions. Unlike the constitutionally combative Margaret Thatcher, Tony Blair doesn't like being disliked, so he has never quite had the courage to take them on.

Hard to earn, easy to lose

The government knows very well that its NHS reforms are too timid to make a difference. So it is hoping—very old Labour—that, if it can only pump in enough money, the cash will do the trick. It is a terrible mistake, both for voters and for the government. Voters will find their taxes wasted on a health service incapable of using their money properly, and the government will lose its hard-won reputation for

fiscal responsibility. And without that, in fact, Labour has rather little to boast about.

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And the case for resisting blackmail

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FOUR main choices face the Cypriots on their divided island. Either the Greeks and Turks who live on it agree to rub along together in a very loosely federal state. Or they agree to separate formally, with fairer boundaries. Or the present edgy stalemate goes on, with both sides growling at each other across barbed wire. Or the island's internationally recognised Greek part is inducted as soon as possible into the European Union, with the Turkish bit set aside until its leaders choose to come back to negotiate. All these choices have drawbacks. But the first—loose federation—is still the least bad. With the island's long-serving Turkish and Greek leaders about to meet for the first time in four years, this is not the moment for outsiders to give up trying to cut a deal.

Why are three of those choices less satisfactory than the first? The present stalemate cannot hold. The poker game over the EU's enlargement—involving Greece's wish to get its island cousins into the club and Turkey's desire to join it some time too—have destroyed the unstable equilibrium of the past quarter century. Many Greeks, and several EU governments, want the internationally recognised Greek-controlled bit of the island brought into the Union, whatever the Turks and others may think. Otherwise, says the government in Athens, it will block the entry into the EU club of ten other countries, an incomparably more important event. If Greece has its way, Turkey, a valued but prickly NATO country, says it may annex Turkish Cyprus outright, imperilling the entire region.

So why not recognise partition—and two separate states on the island—rather than seek to persuade two peoples who plainly dislike each other to live cheek by jowl? The notion is by no means ridiculous. The Turks, who made up 18% of the island's population when their mainland cousins intervened in 1974 after a short-lived local coup threatened to attach Cyprus to Greece, now have 37% of the land. The Greeks would rightly deem a settlement that froze that status quo to be grossly unfair and a shocking endorsement of ethnic cleansing besides. But if both sides agreed to a new share-out, if compensation were internationally adjudged and if boundaries were redrawn to both sides' satisfaction, why not then let them live happily on their own? Fine, in principle. But it would be much harder to get that sort of agreement than the elusive, long-mooted, loosely federal one.

More carrots, please

The Turkish-Cypriots' leader, Rauf Denktash, fears that in any federation the Greeks would do down the Turks. Turkey's powerful generals sympathise. Most Turkish-Cypriots, say pollsters, now want a federal deal to get all of Cyprus into the EU and make all Cypriots richer. In a rare and hopeful step, Turkish businessmen and politicians have begun chastising the rigid Mr Denktash. If they fail to move him, they can bid adieu to any chance of joining the EU in the foreseeable future.

The Greek-Cypriots have moved quite a way in the past few years. They have agreed to have much less sway over the Turks than before the invasion of 1974. They may even, as a helpful gesture, admit publicly that in the decade before the invasion they mistreated the Turkish minority. Still, the EU should refuse to be blackmailed by the Greeks into letting in Greek Cyprus willy-nilly. The UN negotiators, for their part, should ask the Greek-Cypriots to accept not only Mr Denktash's legitimacy as the Turkish-

Cypriots' leader but also the reality of his statelet as more than just an outcrop of mainland Turkey. And if Mr Denktash comes out of his long sulk and agrees seriously to negotiate ways of sharing the island rather than partitioning it, the UN should lift sanctions against his bit of the island as a foretaste of EU benefits to come. It is, after all, in Turkey's as well as Cyprus's interest to give ground.

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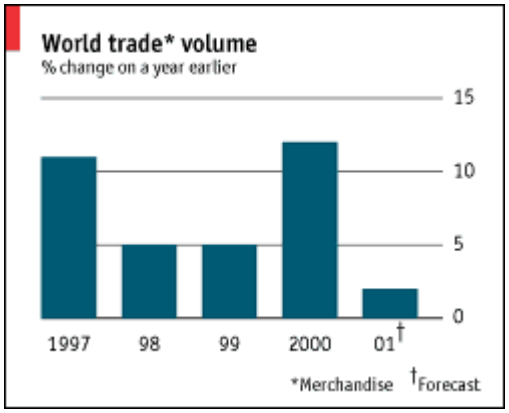
Trade

Just say yes

Nov 29th 2001
From The Economist print edition

Congress should give the administration trade-negotiating authority

Get article background



AMERICAN leadership was indispensable to the successful launch of a new round of global trade negotiations in Doha. Robert Zoellick, the trade representative, deserves special praise for his shrewd deal-making and his ability to broker compromises. Unfortunately, that leadership has now become hostage to America's legislators. Unless Congress approves fast-track negotiating authority (now called Trade Promotion Authority), America's ability to put impetus into the Doha trade talks will be fatally weakened.

Created in 1974 as a procedural device whereby Congress promised in advance to vote for or against trade agreements without trying to amend them, fast-track was relatively uncontroversial for 20 years. But since the mid-1990s it has become the symbol of American politicians' disaffection with trade, and several efforts to renew it have failed.

Ask who gained

The irony of Congress's intransigence has been peculiarly galling—for in decades past Americans have been among the world's biggest beneficiaries from lower trade barriers. Once again America, as both a big agricultural producer and a home to strong services industries, has much to gain from the forthcoming Doha round. Freer trade will not provide a quick fix for today's recession, but it can help to lay firmer foundations for future economic growth.

Equally important, passing fast-track offers America's politicians a rare opportunity to help poorer countries while also helping themselves. Lower trade barriers, particularly in textiles and agriculture, are vital for these countries' economic prospects. Multilateral trade talks are the only way to tear these barriers down. Since September 11th, the stakes in boosting prosperity among the poorest should have become clear even to the most insular American congressman.

So why is the success of fast-track still so uncertain, and the support for trade on Capitol Hill so lukewarm (see article)? The blame belongs in several quarters. First, it lies with the president. Neither George Bush, nor Bill Clinton before him, has used the bully pulpit effectively to make the case for trade liberalisation to ordinary Americans. Mr Bush has devoted almost no political capital to the cause, despite his claims to be an ardent believer in free trade. He said fast-track was among his priorities early in the year, but efforts to pass the legislation have had scant White House involvement. There are excuses, especially since September 11th. But America's pro-trade consensus will not be rebuilt without the president in the lead.

Congressional Republicans, too, bear some of the blame. There are several dozen implacable protectionists in the Republican Party. Mainstream Republicans have failed to seize easy ways to answer the charge that trade harms American workers by, for instance, providing enough help to workers who have lost their jobs.

But the real villains are the Democrats. Many are openly protectionist. Others have disguised their protectionist instincts under a cloak of concern about labour and the environment. Since the fast-track

bill makes serious efforts to compromise on these issues, the Democrats' failure to support it will expose their true protectionist feelings.

Despite these handicaps, success on fast-track is still possible. Mr Bush could use his 90% approval rating to work harder on trade and cajole Congress. Republicans could offer more help to unemployed workers in the fiscal-stimulus bill. And Democrats who claim to be pro-trade could, for once, be asked to prove it. All of this would take political courage—but that is what leadership, in trade as in anything else, is all about.

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Letters

Nov 29th 2001
From The Economist print edition

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Polish woes

SIR – Not all of Western Europe feels a moral obligation to support Poland's EU membership ("Limping towards normality", October 27th). Germany should and does—it wants to atone for carrying out Hitler's pre-war order to kill "without pity or mercy, all men, women, and children of Polish descent". Britain should but does not—it wants to forget about betraying Poland to the Soviets after accepting Polish help and sacrifices that were decisive in defeating Germany.

Gene Sokolowski
Burke, Virginia

SIR – You say that "formerly German territory in the west was given to Poland" and "the coal mines, clustered in the southern, formerly German, region of Silesia". These comments paint a picture of a territorial deal by which Poland obtained a generous gift at German expense. The reality was that Germans, being much stronger, gained control of these lands and claimed them as their own for a few hundred years. This coincided with an influx of Germans "colonising" the area and persistent efforts to Germanise the locals. Stubborn Poles managed to incorporate a large portion of Silesia back into their country after the first world war, and the rest of it 27 years later.

Tom Galek
Adelaide, Australia

SIR – You accept as irrefutable fact allegations that the wartime killings at Jedwabne were "carried out by Catholic townsfolk". Meticulous investigation by historians and journalists—and not just a few on the "religious right"— has exposed evidence that the massacre was indeed planned and implemented by the Germans, with the participation of a relatively few Poles.

President Kwasniewski's apology and "contrite speech" at Jedwabne were, in fact, controversial among Polish society; many interpreted them as another attempt by some in the Polish government to ingratiate themselves with the West and ease Poland's entry into the EU.

Yvonne Kowalczewski
Boston

Disease control

SIR – You say that smallpox has an incubation period of up to 14 days, during which carriers are infectious ("Avoiding a Dark Winter", October 27th). This is incorrect. It is generally accepted, based on published historical data, that a person incubating smallpox is not infectious. An infected person can only infect others while they have symptoms, such as fever, headache, rashes and pustules.

If an outbreak occurs, the relatively long incubation could potentially aid public-health authorities by giving them a chance of identifying those who have become infected, but are not yet infectious. Once identified, those incubating the disease, or with symptoms, can be quarantined, reducing the probability of transmission. In our recent paper we show the importance of using quarantine to halt a smallpox outbreak. We conservatively did not estimate the impact of quarantining those incubating the disease. If they can be successfully quarantined, then an outbreak will be stopped even faster than we modelled.

This may reduce the need to vaccinate large numbers of the susceptible population.

Martin Meltzer
Inger Damon
Jim LeDuc
Centres for Disease Control and Prevention
Atlanta

Dying wish

SIR – As a person in her 70s, with death inevitably drawing closer, my experiences of watching deaths in the older generation and now in near contemporaries have convinced me that I want some say in the time and manner of my dying ("Last rights", November 17th). Being dead holds no terrors for me but the process of dying does.

For five years I cared for my mother who had Alzheimer's disease. When she realised what was happening at the outset, she asked me to procure her some tablets as she did not want to be a silly old woman. She died an incontinent, wandering, unhappy wreck with nothing remaining of the strong, intelligent, person she had once been.

Following a stroke that physically disabled him at the age of 53, my husband repeatedly stated during the five years in which he could communicate that he would not wish to live if he became more handicapped. During the next seven years, following more strokes, he was unable to speak and his behaviour became more bizarre but his eyes and gestures said he wanted to die. In circumstances like these, I would want to die sooner rather than later and in my own home.

Of course there are difficulties framing legislation containing safeguards and of course we must beware of the so-called slippery slope. But these are not good enough reasons for doing nothing.

I would enjoy my remaining years much more knowing there is a legal exit when the time comes, rather than just hoping that I will have an understanding doctor who is prepared to risk trial and possible imprisonment for acting in a humane way.

Diane Munday
St Albans, Hertfordshire

Legendary source

SIR – You object that there is little in my book "Nelson: The Man and the Legend" of "the inspiring leader who reduced some of his captains to tears of excitement" when they heard his battle plan for Trafalgar ("With one eye only", November 24th). The trouble is that the source of this legend, as with so many other Nelson legends, is Nelson himself. It was he who wrote in a letter to Emma Hamilton, that when he told his men about "the Nelson touch" (his phrase), it was "like an electric shock, some shed tears, all approved". We do not have a word that any of his captains wrote on the occasion.

Terry Coleman
London

Reaching out

SIR – I read with great interest the 12-page advertising spread honouring King Fahd of Saudi Arabia (November 17th). I find it reassuring that the good King is reaching out. My concern is why Saudi Arabia continues to teach, in state-sponsored texts, that those in the West are "infidels" and the "enemy". These texts encourage Saudi youth not to associate with Jews or Christians. This is unseemly. Such teachings create the ripples that create the hatred that creates the desire for people to dedicate their lives to destroying the West.

Let's all reach out. I want to reach out to King Fahd: it would make a great impression on me if you would amend those teachings. Do it loud. Do it proud. Change the books.

Glenn Bonci
Seattle

Provisional president

SIR – You note that George Bush may not be the “legally and duly elected president of the United States” (“Correction”, November 17th). May I suggest that, until the election results are definitively established, all future references to Mr Bush in *The Economist* address him as the “provisional president of the United States”?

Andrew Aeria
London School of Economics and Political Science
London

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The ground war

Everybody in - Fighting terrorism

Nov 29th 2001
From The Economist print edition

EPA

America at last puts large numbers of men on the ground

Get article background

NOBODY can accuse the Pentagon of being inconsistent. From the moment the bombing of Afghanistan began, it laid out the following priorities. First, liquidate the al-Qaeda network of Islamist terror, particularly its master, Osama bin Laden. Second, smash the Taliban regime which had been succouring that network. Last, and very much least (if, indeed, this can at all be described as a military objective), create a new order, more stable and humane, in Afghanistan.

From these strategic aims, certain tactics followed. From the start, it seemed clear that gouging the al-Qaeda fighters out of their hiding-places was a job that could be accomplished, in the end, only by soldiers on the ground. But such forces could not be deployed until aerial bombing had created a more or less safe environment in which American boots in substantial numbers could hit the ground.

Early on Monday, November 26th, it seemed that those conditions were finally met. Hundreds of marines had landed by helicopter at an airfield within striking distance of Kandahar, the Taliban's main stronghold and the only large city that remains under their control. The marines' four-hour flight from their ship in the Indian Ocean was the longest-range deployment in the history of the corps. Pentagon officials said the numbers on the ground would exceed 1,000 within a few days. The figure could rise quite rapidly to 10,000, judging by the number of marines, sailors and special forces that are being kept at the ready.

General Tommy Franks, who is in charge of the operation, said the American-led war effort would now be concentrating on two places in particular: Kandahar itself (where American bombers were raining destruction on a compound used by al-Qaeda and the Taliban) and the area between Kabul and the Khyber Pass, including a place called Tora Bora near Jalalabad where it was suspected that the leaders of al-Qaeda, perhaps including Mr bin Laden himself, may be hiding out.

But it was a daunting task, as the general admitted, to block the paths—between 150 and 170 of them—which al-Qaeda fighters may use to flee from Afghanistan to Pakistan. The Pakistanis were struggling manfully to block these routes to fighters, General Franks said, but only “within (their) capability”.

As the marines dug themselves in, one of their commanders made the

“America now

incautious comment that “America now owns a piece of Afghanistan.” In fact, possessing Afghanistan could hardly be further from America's intentions. The general's words were merely a moment of “exuberance”, explained Donald Rumsfeld, the defence secretary, in his deadpan style, which combines blood-curdling threats to the Taliban with homely expressions such as “goodness gracious”, and “holy mackerel”.

owns a piece of Afghanistan,” said one American commander, incautiously

As Mr Rumsfeld made clear, the Pentagon does not view occupying Afghanistan—even tiny pieces of it—as an end in itself. Ground forces will remain in place for as long, but only as long, as it takes to finish off al-Qaeda and its Taliban hosts. Nobody is saying how long that will be. John Pike of Global Security, a Washington defence consultancy, reckons that the Pentagon is preparing to fight on until the spring.

Some of the marines' immediate targets became clear within hours of their arrival. They attacked a Taliban armoured column and claimed to have destroyed several tanks. But despite their eagerness to strike such “targets of opportunity”—targets which were sometimes impossible to identify from the air—the marines' task did not include a frontal attack on Kandahar. The task of “softening up” that ancient walled city was still, at least for the time being, in the hands of America's air force. “Anybody who is there is going to wish they weren't,” was Mr Rumsfeld's grim warning to the al-Qaeda and Taliban leaders who were believed to be holed up in the town centre.

The marines' arrival in southern Afghanistan coincided with an all-but-final victory for anti-Taliban forces in the north. An uprising by Taliban fighters held captive at a fortress near Mazar-i-Sharif was put down by American bombing and some hard fighting on the ground. Several hundred rebel prisoners were killed after they had seized guns and rocket-propelled grenades from their guards (see article).

But the war in Afghanistan was by no means over. For one thing, the Taliban appeared to be digging in their heels in Kandahar. Their spiritual leader, Mullah Mohammed Omar, was apparently well enough to send a radio message to his hard-pressed forces: “Do not vacate any areas.” A bloody showdown was also looming at the Taliban-controlled border town of Spin Boldak. There, surrender talks failed and attempts to wrest the place out of Taliban hands were complicated by the mistrust between four rival commanders on the attacking side, all of whom want a share of the lucrative smuggling route which runs through the town.

Another reason for American caution is that the usefulness as a fighting force of the Northern Alliance's mixture of Tajiks, Uzbeks and others, though greater than many sceptics had believed two months ago, may now be drawing to an end. In the country's southern half, dominated by the Pushtun ethnic group to which the Taliban leaders belong, it is still much less clear who America's natural allies are.

Talking in Bonn

Meanwhile, attempts to find common ground between northerners and southerners were being tested at a conference in an isolated hilltop hotel near Bonn, in Germany. On November 27th, representatives of the Northern Alliance (though not its top people) agreed with various other factions—including Pushtun supporters of Mohammed Zahir Shah, the Rome-based ex-king, and the so-called Cyprus group of Afghan exiles who are backed by Iran—on the outlines of a new government. This calls for the appointment of a small but ethnically mixed executive council as soon as possible; an appointed, but broadly based, legislature by next spring; and elections in about two years. But the northerners are resisting the presence of foreign peacekeepers in Kabul (which they control anyway) while others favour the idea.

The West's governments are not without leverage in the talks. They have made it clear to the Afghan factions that they will not receive the massive injections of humanitarian aid that the country clearly needs unless they can agree on a broad-based government. One wild card, however, is the extent to which the interests of America and Russia—whose leaders have apparently been co-operating very closely—will continue to coincide.

Will Americans and Russians co-operate with each other?

Soon after America's marines flew in, at least a hundred Russians—not exactly soldiers, but armed men from the shadowy Ministry for Emergency Situations—turned up at an airfield north of Kabul. Russia said they were the harbingers of a “humanitarian” effort on which it was prepared to spend lavishly. More probably, this was a bid by Moscow to shore up the position of its favoured proxies in Afghanistan, the

Northern Alliance. Although America's Pakistani friends want a post-war government to include a large number of “repentant” Taliban figures (who would be Pushtuns), Russia continues to insist that veterans of the Taliban be excluded. Despite the warmth and agreement between America and Russia so far in this war, the great game for influence in this hapless country is not entirely over.

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The view from Pakistan

Ties that bind

Nov 29th 2001 | ISLAMABAD
From The Economist print edition

Making do without the Taliban

Get article background

Reuters

Under control

“A WIN-WIN situation all the way round.” That is how, on a Pakistani news programme on November 26th, a buoyant President Pervez Musharraf described the results of his fateful decision to dump the Taliban and align Pakistan with the coalition against terror. He has a right to feel smug. The Taliban are losing; their friends in Pakistan, who many thought might topple the government, have gone quiet for now; Pakistan is regarded as an honoured comrade in the fight against terrorism rather than as terrorism's accomplice; the war's blow to the economy may be relieved by concessions on trade and debt.

Yet it is not hard to make the case that Pakistan has been suckered by its enemies. It would begin with the march of the Northern Alliance into Kabul within hours of an American assurance that it would do no such thing. Pakistan regards the Alliance as a tool of rival powers, including Russia, Iran and India. India reinforced this impression by sending diplomats to Kabul as soon as it could.

The way the Taliban are being crushed adds to that anxiety. Although Pakistan has severed ties, two threads survive. One is the Pushtun ethnicity of most Taliban and some 15% of Pakistanis. General Musharraf must try to ensure that the victory of the Northern Alliance, mainly Tajik and Uzbek, does not imply the defeat of Pushtuns.

The second thread is formed by the thousands of Pakistanis who joined the Taliban. Many probably died in the alleged uprising by prisoners of war near Mazar-i-Sharif, bloodily put down by the Northern Alliance with American and British help. Their fate in Kunduz, the Taliban's last holdout in the north, caused much concern in Pakistan. Some newspapers quoted people in the area as saying that Pakistani aeroplanes had rescued Taliban fighters from Kunduz, a rumour a government spokesman dismisses as “stupid”. Although Pakistan has appealed for humane treatment of prisoners of war, it is unlikely that General Musharraf would welcome back armed zealots liable to make trouble.

The stationing of American marines near Kandahar has prompted fears that they will remain in the region and arrange its affairs to suit their purposes. One newspaper headline this week claimed that America and Britain would have “easy access to Caspian oil”.

All this explains why General Musharraf was at such pains to stress that Afghanistan has not been seized by Pakistan's enemies. The notion that the Northern Alliance is hostile to Pakistan is a “wrong perception”, he said. Nevertheless, he must be praying that the Afghans gathered in Bonn agree on the broad-based, Pushtun-friendly government they say they want.

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Rebuilding Afghanistan

The clarity of devastation

Nov 29th 2001 | ISLAMABAD
From The Economist print edition

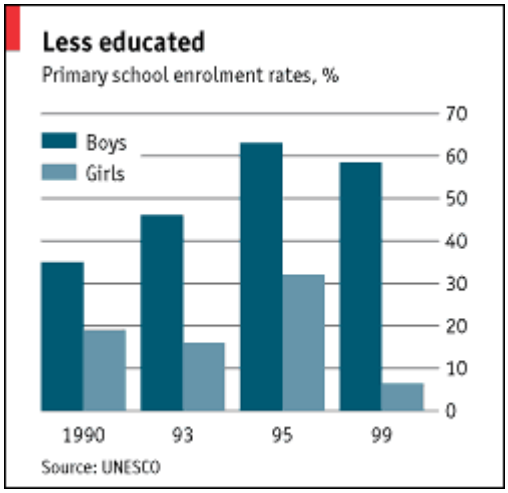
AP

A blank slate has some advantages

CYNICS said that America's bombing of Afghanistan would merely turn rubble to powder; thus avenged, the United States and its allies would then walk away. Now that the Taliban have been put to flight and Afghans are meeting in Bonn to shape a new political order, work has started on a rebuilding programme that should prove the cynics wrong. On November 27th-29th more than 300 representatives of UN agencies, development banks, donor governments and NGOs, many of them Afghans, met in Islamabad, Pakistan's capital, to peer into the future.

A quarter-century of war and three years of drought have made Afghanistan almost unimaginably wretched. Nearly 4m Afghans have left the country and about 7m, a third of those who remain, depend on food aid for their survival. More than a quarter of the children die before they are five; only 6% of girls are in school. The drought has cut agricultural production, the livelihood of most Afghans, in half. Land mines and unexploded bombs kill or injure 500 people a month. In some areas, irrigation systems have been mined to displace the local population.

Institutions that function in other poor countries barely exist in Afghanistan. Most doctors have left and 85% of teachers have either joined them or been killed. In 1993 60% of power lines did not work; the figure now is thought to be much higher. The central bank does not seem to be exercising proper control over the printing of the national currency, the afghani.



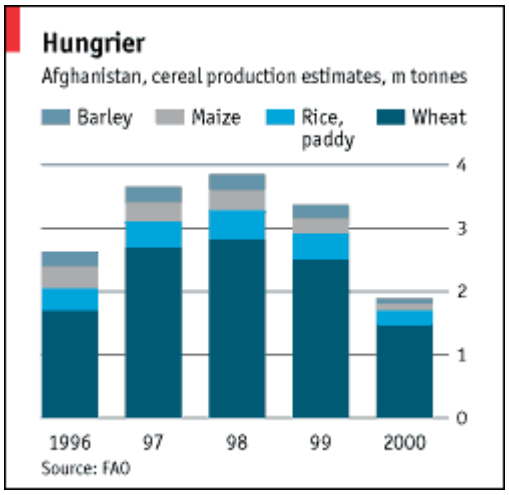
Devastation, though, at least brings clarity, for it means that Afghanistan can be rebuilt without repeating the mistakes made by other countries in the region. There is not much talk of reform at the Islamabad conference, because there is little to reform. The word reconstruction itself seems inapposite. Much of what Afghanistan must now build never existed or was in its infancy decades ago. In the early 1980s, for example, little more than 10% of girls, nearly all of them in cities, went to school. The papers now coming out of the World Bank and similar institutions are free of the usual clichés about bloated and corrupt bureaucracies, unsustainable welfare and subsidy programmes, high and variable customs duties and the rest. Anything that could be dismantled already has been, if it ever existed at all.

One way to deliver aid, and promote good behaviour at the same time, could be a trust fund, which would handle a big chunk of the $1 billion-2 billion a year of foreign assistance that Afghanistan is

expected to need over the next ten years. The idea has been used in other areas where war supplanted government, such as the Palestinian territories and East Timor, to check both donors and recipients. Donor governments often twist aid programmes by dictating how their money is used; a trust fund would pool their contributions. Working through Afghanistan's budget and a “reconstruction agency”, which might contain the embryos of government departments, a trust fund could help ensure that the money goes where it is needed most.

The World Bank is championing the idea, but it could face opposition. Government aid agencies may not easily yield the power to brand specific programmes and the kudos that goes along with that. NGOs may resent being answerable not only to a fledgling Afghan government but to an internationally administered body.

More than lip service is being paid to the idea that Afghans themselves should have a say in how the money is spent. “We have made people listen,” says Mohammed Ehsan, an exiled Afghan who works for Norwegian Church Aid. And there seems to be agreement on what the early priorities ought to be. Alongside deliveries of food and other essentials to the most vulnerable people, which war slowed but did not halt, Afghanistan's rebuilders are plotting “quick wins”. Many of these are simple public-works programmes, such as rebuilding roads, repairing irrigation canals and clearing land mines, which would put a lot of people to work quickly on projects that meet obvious needs. They can also help to attract refugees back to their homes and thousands of armed men away from unruly militias.



Meanwhile, the slow work of building structures and institutions that are meant to last can begin. It will have to contend with politics, ambition, greed and other forces that disrupt progress in most other countries. Some quick wins will make the long slog easier, and quieten the cynics.

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Bin Laden's foreign fighters

Follow the leader

Nov 29th 2001 | BENI HISSAR
From The Economist print edition

True believers on the front line

Get article background

AP

One of his blue-eyed boys

ONE night at the end of October, Osama bin Laden and 120 bodyguards came to spend the night at the camp of Beni Hissar, near Kabul. He told the camp boss that he would leave at eight the next morning. But he got up at five, prayed and then left. After that, everyone else was ordered out on the news that a missile strike was imminent. The rockets struck at eight.

Since missile strikes happen with little or no warning, Mr bin Laden evidently has some very reliable sources of information. The best of these, operated by his legion of foreign supporters, is linked by a sophisticated Codan radio network, of the type used by the United Nations and aid workers in places such as Afghanistan. Despite the destruction early in the air war of the Taliban's air defences, Arab and Afghan residents of Beni Hissar were given frequent warnings, via this network, of possible strikes by aircraft.

The two missiles struck a house right in the middle of the Beni Hissar camp compound, which sits below hills on the outskirts of Kabul. It used to be a headquarters for Mr bin Laden's foreign legion, and was run by a Sudanese called Abdul Aziz. After the attacks on America of September 11th, 15 Afghans working at the Taliban's Ministry of Education were sent here to take over non-essential tasks so that all the Arabs could go and fight.

"Everyone who works for Osama is like Osama", says one Afghan

All of them have now fled except one, a 23-year-old who calls himself Amin. He is a frightened man, who will talk to a foreigner only in a moving car. His job was to run the camp's finances. He was amazed how much money and food there was both for the Arabs and for the Afghans who were drafted in to work with them. The Afghans were due to be paid $120 a month for their contribution to the cause, roughly the annual salary of a professor at Kabul University. The Arabs got more.

The 850 soldiers who answered to Abdul Aziz came from across the Muslim world, but most were Egyptians, Saudis, Lebanese and Qataris. According to Amin, at the end of October they were joined by 40 Arabs who had been living in Germany and Italy and who travelled via Iran. In the remains of the camp building are torn-up air tickets showing that they travelled first to Syria and then, on October 29th, to Iran.

The financial muscle of the Arabs meant that they did not take orders from the Taliban's Ministry of Defence. Indeed, they were often used to shore up crumbling lines when the Taliban's own Afghan fighters started to run. When the front line north of Kabul began to collapse, it was the Arabs who were sent to stop the rot. They ordered the Afghans to get back to their positions. Such foreigners were also deployed to stop Afghan Taliban defecting from Kunduz, and were said to have done so with great brutality.

Western leaders rejoice at the apparent rout of the Taliban in most of Afghanistan. But that is not how Amin and his colleagues see it. The Taliban and Mr bin Laden do not believe in nation states, but in a far wider Muslim entity (sometimes talked of as a Caliphate) stretching from Indonesia to the Atlantic. Looked at this way, the cause has not lost most of its country but has simply surrendered a tiny bit of ground to save its troops so that they can live and fight another day.

And what if Mr bin Laden himself is killed? Amin explains: “Everyone who works for Osama is like Osama. So after Osama it might be Abdul Aziz, or someone else. Everyone loves him.” Asked whether he would be prepared to die as a suicide bomber, killing women and children in the West, he says: “*Inshallah* (God willing), I will go. It is our way, it is the way of Allah because these people are unbelievers.”

If the coming days bring the fall of Kandahar and the killing or capture of Mr bin Laden, celebration will be premature. For people like these, it is merely a battle lost; the war will be far from over.

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Captured Taliban

No quarter

Nov 29th 2001
From The Economist print edition

Disturbing scenes in Qalai Janghi and Kandahar

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AP

Victor and vanquished

ARE the laws of war being broken by America or its Afghan allies in their fight with the Taliban? Arguments over this question are bound to grow louder as western journalists—and television cameras—survey the grisly aftermath of some of the latest battles.

At Qalai Janghi, the mud-walled fortress where an insurgency by Taliban prisoners was suppressed—largely by American bombing—at the weekend, correspondents found that some of the hundreds of charred corpses had their arms tied together above the elbow. Although it was clear that the rebelling prisoners had been heavily armed, the scenes of devastation are bound to embarrass the American-led coalition.

Human Rights Watch, a New York-based lobby group, has been arguing that captured Taliban prisoners must be treated humanely and with due process; they must neither be killed in cold blood, nor amnestied in cases where there is enough evidence to put them on trial for war crimes. And where they wish to surrender, they should be allowed to, the campaigners say—pointing out that “giving no quarter” is explicitly forbidden by the Geneva Convention. London-based Amnesty International, meanwhile, wants an enquiry into whether the slaughter of prisoners at Qalai Janghi was a violation of the Geneva Convention's articles on the safety of prisoners of war.

The Pentagon is also looking into an incident in which anti-Taliban fighters apparently killed as many as 160 unarmed prisoners after a battle for the town of Takteh Pol, between Kandahar and the border with Pakistan. But the Taliban's local foes seem unfazed by these discussions, perhaps because they remember how the Taliban behaved when they could.

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The economy

Nobody looking at the road

Nov 29th 2001 | WASHINGTON, DC
From The Economist print edition

Through a mixture of apathy and partisanship, Congress and the president seem to be making a mess of economic policy

CLEAR presidential leadership and unusually strong bipartisan congressional support have been the political hallmarks of the war against terrorism. Would that the same could be said for domestic economic policy. For all the talk since September 11th of political co-operation to provide a boost to the economy, two important pieces of economic legislation—the fiscal stimulus bill and the “fast-track” negotiating authority George Bush wants for trade—are not yet law. They have been the victims of ineptness and apathy from the White House and partisan rancour on Capitol Hill.

The progress of economic stimulus legislation over the past two months is a case study in how not to pass good laws. Initial enthusiasm from both Democrats and Republicans to give the flagging American economy a quick shot in the arm soon gave way to traditional partisan proposals and a penchant for handing out pork.

The slim Republican majority in the House pushed through a $100 billion stimulus bill on October 24th. Focused overwhelmingly on tax cuts, it included a variety of things not known for their immediate stimulative impact, such as that old conservative favourite, a capital-gains-tax cut, as well as numerous corporate-tax breaks. Even Paul O'Neill, Mr Bush's treasury secretary, dismissed the process as partisan “show business”.

In the Senate, the Democrats began by pushing a $73 billion bill that offered some tax cuts, but concentrated on more spending for unemployment insurance and health insurance for unemployed workers. These efforts were adorned with fine rashers of prime bacon—notably a proposal to offer special assistance to bison farmers. Democrats also insisted on boosting spending on homeland security by $15 billion. Senate Republicans, who want a bill designed much more clearly around tax cuts, killed the Democrat proposal in mid-November—and stalemate set in.

This week finally brought some signs of progress. Senate Republicans have scaled back their proposed business-tax cuts, while boosting unemployment benefits and health-care assistance for unemployed workers. They have removed the idea of a $300 rebate for low-income workers and replaced it with a new proposal—a one-month holiday from payroll tax for both employers and employees—which some Democrats seem open to. And the Democrats have dropped their demand for more spending on domestic security.

Meanwhile, Mr Bush is finally ramping up the pressure from the White House. On November 26th, he used the official announcement by the National Bureau of Economic Research that America has been in recession since March (see article) to demand the legislation be passed before Congress adjourns for Christmas. In a speech on November 28th, he said that 415,000 jobs have been lost while Congress bickered about the stimulus, and that "the American people expect it, and I expect it."

Unfortunately, this White House leadership may be too little, too late. Though Mr Bush has offered principles to guide the stimulus package during the past couple of months, his economic team has been singularly inept at getting them implemented. Mr O'Neill, for instance, irritated first House Republicans with his derision of their bill, and then Senate Democrats by dismissing their "pathetic spending bill".

White House leadership may be too little, too late

But the White House has also taken an unduly partisan stance when it comes to defining its stimulus—to the point where it excludes spending. Earlier this month, Glen Hubbard, the Chairman of the Council of Economic Advisors, warned in the *Washington Post* that "[government] spending should not be confused with a stimulus." (Which is nonsense: government spending can boost an economy in recession, as indeed can tax cuts. Equally, poorly planned spending can be counterproductive—just as bogus tax cuts can be.)

Partisan theology is also blocking progress on another important, though less visible, economic bill: fast-track negotiating authority. This authority, under which Congress promises to vote on any trade deal negotiated by the executive without trying to amend it, lapsed in 1994. Efforts to pass it failed in 1997 and 1998. Without fast-track, little progress will be made either in negotiating the regional Free Trade of the Americas agreement or, more importantly, in the new round of global trade negotiations.

Pro-trade Republicans have been trying unsuccessfully to get fast-track passed all year. After numerous false starts a vote has been set for December 6th. The prospects of success, however, are uncertain.

Very few Democrats seem prepared to vote for free trade. Their standard excuse— that environmental and labour issues are insufficiently addressed—looks increasingly flimsy. By common consent, the fast-track bill, which is co-sponsored by Bill Thomas, the Republican chairman of the House Ways and Means committee along with three brave Democrats, deals with this relatively generously. More than any other recent fast-track deal, this one instructs American negotiators to include trade-related environment and labour provisions as negotiating objectives that will be enforceable in future trade deals.

So leading Democrats are quickly latching on to other spurious worries. Dick Gephardt, the Democrat leader in the House, for instance, has suddenly bemoaned the Bush Administration's decision to agree to examine rules on anti-dumping in the Doha trade round.

Putting troops in the field

The real reason for much Democratic intransigence has nothing to do with any of these specifics. It is because many Democrat lawmakers fear the power of the unions. But it means that no more than 25 Democrats are likely to vote for fast track. With the two parties so evenly split (the Republicans have a six-seat majority in the 435-seat House), that means the crucial question is how many Republicans are likely to vote for it.

The answer, historically, is nowhere near enough. Despite their claim to be the party of commerce, the Republicans have always had a strong isolationist streak; and there are also plenty of businesses, such as textiles, that have little to gain from free trade. According to Mac Destler, a trade expert at the University of Maryland, at least 50 Republicans have voted against every major trade agreement since the NAFTA vote in 1993. The last fast-track vote in 1998 found 71 Republicans voting against it.

Will Mr Bush use his sky-high approval ratings to bully fast-track through?

Given these odds, fast-track's only hope lies in Mr Bush using his sky-high approval ratings to bully the thing through. Unfortunately, the White House's trade offensive has been considerably less vigorous than its push in Afghanistan. Although Mr Bush mentioned the need for fast-track on November 26th, he has hardly been using the presidential bully pulpit to make a strong public case for freer trade. Nor has there, as yet, been much concerted cajoling of individual congressmen.

Presidential clout can work. In the run up to the vote on granting normal-trade status to China Bill Clinton ran a clear campaign to persuade wavering lawmakers. With luck, Mr Bush will do something similar over the next week. If he does not, even insiders think that fast-track is doomed.

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The deflated north-west

Pop goes Seattle

Nov 29th 2001 | SEATTLE
From The Economist print edition

Nowhere in the country feels as low as the part that had soared highest

WHEN the American economy was running full-tilt two years ago, few places were as breathlessly delighted as Seattle. Its port was thronged with ships bringing goods from Asia. The Boeing company could barely keep up with demand for its airliners. Microsoft was hiring hordes of software engineers. After each rain shower, another Internet millionaire sprang up. Here was a city that had it all—Old Economy, New Economy, Not-Yet-Invented Economy.

Now it has all gone sour. The past 12 months have been a non-stop succession of disappointments. Boeing's headquarters decamped to Chicago. The Internet economy popped like a balloon in a nail factory, taking with it once-promising local ventures such as Homegrocer.com and leaving can't-possibly-miss companies such as drugstore.com barely hanging on. And an already troubled Boeing was hit even harder after September 11th both by a steep drop in airliner orders and by losing a $200 billion Joint Strike Fighter contract to Lockheed Martin.

Washington state, battered by what is happening in Seattle, now has the highest unemployment rate in the United States—6.6% compared with 5.4% in the country as a whole. Right behind it is next-door Oregon, another former boom state, with 6.5% of its workforce out of a job, the country's second-worst figure. In Oregon, manufacturing's collapse has caused the loss of nearly 30,000 jobs in a year; those hit range from Freightliner, a maker of heavy lorries, to high-tech companies such as Intel and Fujitsu.

What makes the current plunge so painful is that every part of the economy seems to have stepped into an open manhole at the same time. Three years ago, when Boeing began to remove more than 20,000 workers from its factories in the area, they found work easily. Now, another 20,000 people that Boeing expects to lay off by the middle of 2002 have to compete with unemployed workers not just from the high-tech industry but from construction work and even the retail sector. Portland now has more jobless than the other parts of Oregon: the opposite of how things were a few years ago.

Every part of the economy seems to have stepped into an open manhole at the same time

Even worse, the Pacific north-west's downturn, as well as being deeper than the rest of the country's, may also last longer. One reason for fearing this is Boeing's continuing woes.

Nowadays Boeing accounts for less than 5% of employment in the Seattle area, down from 9% two decades ago. But it remains the foundation on which the rest is built. Its network of suppliers and subcontractors gives it a far stronger multiplier effect than, say, Microsoft, which is more an island of prosperity than the centre of a web. The chances are that Boeing will not really bounce back until the assumed revival in air travel persuades airline companies to start buying plenty of aircraft again. And that may not be until 2003.

On the other hand, once a national recovery begins, the north-west could eventually find itself once again at the top end of the seesaw. Its high-tech economy ranges from microprocessors and wireless telephones to software and biotechnology. Even now, Microsoft expects to hire 4,000 workers in the coming year, and its presence makes the area attractive to knowledge workers of all sorts. Companies like Starbucks, Amazon and Nike are still magnets for talented people, some of whom then take their how-to-succeed knowledge into start-up companies.

Some people reckon the present slump will be followed by a revival, starting in 2003, that could make the rest of the country envious. Mike Slade, a venture capitalist in Seattle, believes the north-west's enormous intellectual horsepower will go to work creating scores of small businesses which, within two or

three years, will generate plenty of new jobs. That, combined with the natural advantages of Oregon's and Washington's plethora of famous companies, its well-trained workforce and its natural beauty may not quite reproduce 1999's economic brilliance. But a warm new glow would do very nicely.

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Public opinion and the war

Vox populi, vox belli

Nov 29th 2001 | WASHINGTON, DC
From The Economist print edition

No regrets so far, ready to take casualties, and, Saddam, you're next

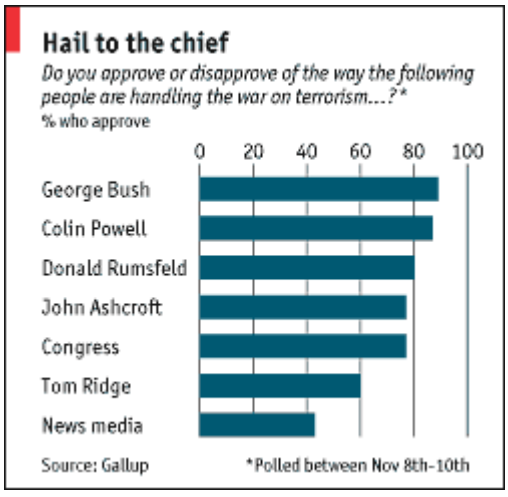
Get article background

IT IS still not clear what the perpetrators of September 11th's acts of terror hoped to achieve. But if it was to demoralise the American people and force their government to shy away from further action in the Middle East, it has not worked. That is the clear conclusion from polling evidence gathered by Gallup for a symposium in Washington, DC.

The evidence of resilience can be found in almost every survey. Most Americans were profoundly moved after September 11th. Seven in ten of them reported feeling depressed; six said they cried; five had trouble sleeping. But, although most people expected more attacks, they have made a conscious attempt to return to normal. By mid-October, one Gallup poll found 89% of Americans say that they were "going about their business as usual". Only one in a hundred has gone out to buy a gun. And, despite the media storm about anthrax in October, an ABC/*Washington Post* poll at the end of that month found that 92% thought their mail was safe.

Bill Schneider, a political analyst with CNN, characterises the current mood as one of "defiant optimism". Americans are rallying round the symbols of national unity—particularly George Bush (see chart). Some 67% approve of the way that the country, both at war and in recession, is going. A determination not to let the bastards grind you down may play a part; so too may the discovery that America is not just a land of self-absorbed baby-boomers, but of patriots and heroes as well.

The figures make mixed reading for civil libertarians. Four out of five Americans are willing to sacrifice some freedoms for the sake of greater security, 77% support a national identity card and 64% back military tribunals for terrorist suspects. But clear majorities also oppose allowing the government to monitor people's telephone calls and e-mails, and allowing the police to stop and search people at random. Most people object to picking on Arab-Americans: 57% support requiring all residents to carry an ID card, compared with 49% who back confining it to Arabs.



For America's generals, the figures are unambiguously good. Backing for military action remains as high as it was just after September 11th, at almost 90% of the population. Support for the war is even strong among groups that have traditionally had pacifist leanings, such as women (84% in favour) and "liberals" (77%).

This backing is not conditional on an easy victory. A solid 94% of Americans expect the war to be difficult. The latest figures show 61% willing to use ground troops even if thousands of Americans are killed. There are big majorities for using troops even if it increases the chances of retaliation (87%) or means higher taxes (84%) or a petrol shortage (79%).

For those now seeking to expand the war on terrorism, the polls offer plenty of encouragement. Some 92% expect a long war. (The comparable figure after Pearl Harbour was only 51%.) No less than 56% would be willing to see combat forces used for more than five years if necessary. Virtually half, 49%, say they favour a broader war, compared with 43% who want to limit the war to

Watching body bags come home is very different from telling

punishing those responsible for September 11th. In a new *Washington Post* poll 78% back using American troops to topple Saddam Hussein.

pollsters you are willing to take casualties

Like all polls, the research is a snapshot, not a predictor. There is a big difference between telling pollsters that you are willing to take casualties and actually watching the body bags coming home every night—particularly if Osama bin Laden himself were to have been killed.

But two things could check the natural tendency for support to erode over time. One is the degree of international support America enjoys. Ever since Vietnam, Americans have been worried about going it alone in foreign policy. Some 95% deem it very important for the war against terrorism to be a collective effort of many countries; 85% favour working through the United Nations. The other thing is leadership. Mr Bush has been remarkably successful at shaping public opinion, on everything from how long the war is likely to last to embracing Arab-Americans.

Iraq would be a challenge on both counts. This week, Mr Bush's people have once again been hinting about “dealing with Saddam”. But convincing Americans that an unpleasant regional bully is a threat to their security could be hard, particularly if many of America's allies do not agree. All the same, the Iraqi dictator should be fully warned of his peril.

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Fighting eco-terrorism

The green threat?

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Violent environmentalists may soon start feeling the heat

AP

ISLAMIC terrorism may be a distant threat for Shearer Lumber Products, a timber company based in Idaho. But eco-terrorism is a very real one. In November, the Earth Liberation Front (ELF), an underground organisation, gave warning that it had "spiked" trees in the Nez Perce national forest to protest against logging. (Spiking involves hiding metal bars in tree trunks, thereby crippling chain saws and, potentially, hurting people.) More such attacks are expected. How do they fit into America's war on terrorism?

The nation's forests have seen a sharp increase in violent incidents—equipment vandalised, people intimidated—over the past ten years. Shearer now carefully inspects every tree before cutting and has been using metal detectors to check every trunk being processed. Yet Ihor Mereszczak, of the Nez Perce Forest Service, says it has been hard to get the FBI's attention, and investigations have got nowhere.

The ELF is only one thread in a web of underground radical environmentalists. Its aim is to inflict as much financial pain as possible on organisations or people who, by its lights, are exploiting the environment. The ELF, though made up of anonymous cells, nonetheless operates a website offering tips on how to cause fires with electric timers. Until recently, it also had a public spokesman.

Together with the Animal Liberation Front (ALF), which operates along the same lines, the ELF is estimated to be responsible for over $45m-worth of damage in North America over the past few years. In 1998, it caused fires that did $12m-worth of damage in Vail, Colorado, to make the point that the ski resort's expansion was threatening places where lynxes live. Earlier this year, the ELF burned down the offices of a lumber company in Oregon. Since September 11th, the ALF and ELF have claimed responsibility for starting a fire at a primate research centre in New Mexico, releasing mink from an Iowa fur farm, and firebombing a federal corral for wild horses in California.

Are they terrorists? The two groups reject the label, claiming to take all precautions against harming "animals, whether humans or not". But earlier this year Louis Freeh, the FBI's boss, listed both organisations among the most active domestic terrorist groups. Scott McInnis, the Republican congressman whose district includes Vail, argues it is only a matter of time before somebody gets hurt; he now expects the FBI to put in more resources.

The House subcommittee on forests, which Mr McInnis heads, will hold a hearing on eco-terrorism in February. Craig Rosebraugh, the ELF's spokesman until September, has been subpoenaed, after refusing to testify voluntarily. But Mr McInnis has annoyed some mainstream green groups by asking them to denounce the ELF's and ALF's methods. Greenpeace, for instance, says that its disapproval is self-evident, and resents being asked to express it. Mr McInnis still wants their answer by December 1st, but the war on eco-terrorism is off to a rocky start.

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Trading cards

Real heroes

Nov 29th 2001 | ST LOUIS
From The Economist print edition

Reuters

My two Donald Rumsfelds for your Condoleezza Rice?

IN A famous “Peanuts” cartoon Lucy asks Schroeder: “If Beethoven was so great, how come they never put him on a baseball card?” Now George Bush, Osama bin Laden and Donald Rumsfeld have met Lucy's measure of greatness. Their mugshots are among those featured in a set of trading cards called “Enduring Freedom”, a hot property on playgrounds across America.

The 90-card set (sold in packs of seven with a bonus sticker) mostly concentrates on military hardware, but it also includes photographs of Rudy Giuliani, Tony Blair and members of Mr Bush's cabinet and advisory bodies (pity the boy stuck with a Norman Mineta). Topps, the company which produces the set, is based just a bagel's throw from the site of the World Trade Centre. Normally it specialises in sports-related cards, though it has in the past published cards on the Korean war and the Gulf war (but not Vietnam). A pack of seven “Enduring Freedom” cards sells for $1.59; you can buy the lot for $49.99.

In a comparable vein, Marvel Comics—fabled home of Spiderman, Captain America and the Incredible Hulk—has brought out a special comic book celebrating America's “real superheroes”: the New York police and firefighters. By bringing these figures out of the background, where they have traditionally loitered idly as Spidey does his thing, and turning them into the stars of the main action, Marvel pays them a special compliment. Kids are clearly getting the message. This Halloween, some trick-or-treaters donned the garb of these new, real-life heroes, leaving their more fantastic costumes in the wardrobe.

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Hmong-Americans

They earned it

Nov 29th 2001 | WASHINGTON, DC
From The Economist print edition

A last-minute reprieve for Hmong fighters seeking American citizenship

AP

Eighteen months to go

THE Hmong people of northern Laos are a tough lot. Their home is a tangle of rugged subtropical mountains, and, when they were recruited by the CIA during the Vietnam war, they fought Ho Chi Minh to a draw. Now the survivors of that time are considering whether to march on Washington, this time in a gentler cause.

The North Vietnamese communists sent about 70,000 troops into northern Laos and killed some 35,000 Hmong, though they never entirely conquered the north. After the communists' victory in lowland Laos, many of the Hmong who had fought on the American side fled to America with their families. There they faced problems of a different kind. Cities such as Minneapolis, where large numbers of Hmong settled, were a far cry from the highlands of Laos. And, perhaps understandably, most Americans knew little of what the Hmong had done in the war.

Yet, with characteristic resilience, the Hmong soon became a political force in their adopted homeland, particularly in Minnesota, Wisconsin and California. Congressmen from the districts where they now lived became vigorous advocates of Hmong causes. Without American citizenship, the Hmong could not qualify for ex-servicemen's benefits. So lobbies were formed to demand citizenship for roughly 45,000 Hmong and their families.

Legislation passed by the Clinton administration in 2000 said the Hmong could use translators when taking their citizenship examinations. Since that apparent breakthrough, however, little progress has been made. Only about 4,000 of the 45,000-or-so Hmong who are, by law, eligible for citizenship have actually been granted it. The badly drafted law excludes those who entered the United States before 1980. Many Hmong remain unaware of their right to citizenship, largely because they have not been properly informed about it in their own language.

The Immigration and Naturalisation Service (INS) did not begin to implement the measure until last summer. Even then, it went about it pretty haphazardly. Philip Smith, a lobbyist for the Lao Veterans of America, claims that some regional INS offices still turn away Hmong who ask to take the citizenship test with a translator's help. And the citizenship law was due to expire this week, on November 26th.

But all is not lost. Congress has agreed (but not yet passed) an extension to the deadline of 18 months, during which time Hmong applicants for American citizenship may still take the examination in their own language. To make it clear that, this time, they want to be treated seriously, Hmong ex-servicemen are planning a march in Washington in which they will wear either wartime battle-dress or the traditional warrior gear of the Hmong. Perhaps that will do the trick.

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About sponsorship

Lexington

The politics of cloning

Nov 29th 2001
From The Economist print edition

An old idea could prove useful in a new debate

Get article background

WHEN the history of the 21st century comes to be written, Sunday November 25th is likely to contribute at least a footnote, and possibly the start of a chapter. That was the day when a previously obscure Massachusetts company, Advanced Cell Technology (ACT), announced in an equally obscure on-line journal that it had cloned the first human embryo.

Whether this is a scientific milestone remains doubtful (see article). The company was not trying to create a human being (reproductive cloning, in the jargon), just an embryo, from which it could derive stem cells (therapeutic cloning). Stem cells, which can transform themselves into any of the body's tissues, promise cures for degenerative diseases, such as Parkinson's. But the company got nowhere near that aim. All the embryos died and it is unclear whether the company prompted the eggs to produce any new cells. No wonder the professor who chairs the ACT's ethics board cautiously described the cells not as “embryos” at all but merely as “cleaving eggs”. Nonetheless, for a few hours, the first making of a human life was stirring in a test tube, put there by genetic manipulation.

For many people, this was an enormously significant point: a toe across a fuzzy line into uncharted territory beyond. After all, Columbus got the credit for discovering a place that purists might argue he never really reached.

Certainly, while the scientists have equivocated and nit-picked, the response of America's politicians has been straightforward and fierce—particularly from conservative opponents of abortion. George Bush took time off from the war to criticise the research as “morally wrong” and called on the Senate to ban cloning (which the House has already voted to do). “Let's be clear,” thundered Dick Armey, the Republican majority leader in the House, “we are in a race to prevent amoral, scientifically suspect tinkering with the miracle and sanctity of life.”

While scientists have equivocated and nit-picked, America's politicians have responded fiercely

All very predictable—and overly simple. For behind this bombast lies an uncomfortable fact: the politics, ethics and even theology of the unborn are getting much more complicated. Nobody knows this better than Mr Bush himself, who spent much of this summer agonising over whether to allow federal money to support stem-cell research that used discarded embryos—and decided to let it continue. Several anti-abortion senators support stem-cell research because it may help to save lives, which explains why the Senate leadership is reluctant to hold a vote soon on banning cloning.

Nor is it just a matter of satisfying Republican lobby groups. The knee-jerk reaction against cloning this week made no attempt to distinguish therapeutic cloning from reproductive cloning. Plenty of those who normally support scientific progress, including this newspaper, are uneasy about reproductive cloning. In the words of Leon Kass, the head of Mr Bush's new bioethics panel, it “turns procreation into manufacture”. It also requires trial runs which—if the experience of animal cloning is anything to go by—will involve the deaths of thousands of implanted cloned embryos and countless deformed babies. Those seem decent reasons for a moratorium on reproductive cloning.

The knee-jerk reaction against cloning has not tried to distinguish therapeutic cloning from reproductive cloning

Therapeutic cloning is different. Here the main objection is a simple theological one. Stem cells created from embryos allowed to live until 14 days (the usual

limit for therapeutic cloning) may have marvellous medical benefits. But if you believe, as many people do, that life begins at the moment of conception (or, in the case of cloning, the moment of the first cell division), then you have to oppose every type of cloning.

Yet many Americans find this absolutism difficult; and they do distinguish between the two different sorts. Nine out of ten oppose baby cloning, with its images of Dr Frankenstein and glowing test tubes. But when it comes to balancing the loss of an embryonic life against the possible saving of a life blighted by Parkinson's, diabetes or worse, they seem more divided. A slim majority supports research on the spare stem cells left over in fertility clinics. Yet, arguably, pro-lifers should be even more adamantly opposed to therapeutic cloning (which destroys an embryo) than to reproductive cloning, which lets it live.

Define your terms

Could anything help to find a way through these conflicting views on embryo research? Yes, as it happens. The starting point is that people, understandably, feel less queasy about playing God with a handful of cells than they do about meddling with a recognisable human being—a feeling that shows most clearly in the abortion debate, where many more people oppose late-term abortions than early ones.

The helpful theory is an alternative theological view of “life”, called “quickening”, that predates the modern pro-life view. Quickening was acknowledged in Aristotle's “Politics” and medieval Christian doctrine, as well as being codified in English common law. It held that life begins when the mother can first feel the kick of her baby, usually at around four months (before the point at which the baby is viable). More broadly, it held that there is no single moment when life can be said to begin with certainty: it comes about through a process of quickening.

Obviously, there is no scientific validity for this belief. But it makes good psychological and common sense (ask any mother), and was not rejected by the Catholic church until 1884. Its legal applicability may be limited, but, as a rule of thumb, it has certain advantages. It would allow people to oppose cloning humans on principle, but support therapeutic cloning on the grounds that this involves experiments on cells that do not yet have a human life. It even makes it possible to say these things without taking a firm view on when exactly you think life begins. The concept of quickening may not, perhaps, change many Americans' minds. But an idea that mirrors what most people seem to feel anyway may yet have a political use.

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Government in Mexico

Baby steps towards change

Nov 29th 2001 | MEXICO CITY
From The Economist print edition

A year after Vicente Fox took office, what is new in the new Mexico?

Get article background

YOUR correspondent has taken this bus trip out of Mexico city many times before and, as always, the bus has barely left the station when a film starts on the video monitors. Yet something is different. Usually these films begin with a message informing the passengers that the videotape they are watching is for home use only and that public screening—such as on a bus—is strictly prohibited. This time, though, the tape is licensed for public viewing.

Why mention such a trivial change? Because those are the signs to watch for in the new Mexico. A year after taking charge, ending 71 years of rule by the Institutional Revolutionary Party (PRI), Vicente Fox's government is under fire for not having achieved anything big. But it is in the small things that the differences lie—and not necessarily in the things that the government itself is doing.

The critics agree on what Mr Fox is not doing. They point to a lack of clear plans and priorities; a lack of management, leaving ministers to follow their own agendas and bicker openly; poor public relations, with press offices still bureaucratic mouthpieces rather than sources of imaginative spin; and a heavy-handed relationship with Congress that has antagonised the political parties, including Mr Fox's own National Action Party.

The result: the big plans, such as raising more taxes, boosting education spending, opening up the energy sector and creating a truth commission to clear up the shady past under the PRI, have been either delayed or dropped altogether. And Mr Fox's propensity for careless talk, providing fodder to the newly querulous media starved of hard news, does not help.

The president is characteristically unrepentent. “I believe there are no mistakes,” he says. He talks of progress in human rights: his government has released two environmentalists wrongly jailed by the previous one, and this week set up a special prosecutor's office to investigate forced “disappearances” in the 1970s and 1980s. True enough, but reforms to the police, army and justice system in order to prevent future abuses are nowhere in sight.

Even more tellingly, most of the other achievements Mr Fox mentions, such as low inflation and unemployment, a stable economy and the Progresa anti-poverty programme, were legacies of the previous government. But they are no less important for that. With unfortunate timing for Mr Fox, Mexico's economy has slipstreamed into recession behind that of the United States, which takes nine-tenths of its exports. That is not surprising. “The remarkable thing is that for the first time in three decades, we have a recession without a financial crisis,” says Guillermo Ortiz, the central bank's governor. All the more remarkable since it also coincides with the transition to democracy.

Though Mr Fox is still reasonably popular, the lack of obvious innovation has frustrated critics and supporters alike. When one senior official was asked, “What's new in the new Mexico?” he swore quietly: “Nothing. It's a mess.”

Yet there is another way to see the mess. “Everything has changed,” says Luis Rubio, a political analyst. “Before, the PRI was a key link in the chain of command.” The party, with control of nearly every

government body, trade union, social organisation and (until 1997) Congress, buttressed the president's authority. Mr Fox's floundering is partly because the checks and balances that were merely notional under the PRI now function with a vengeance. Earlier this year, for instance, his attempt to decree a minor change to the rules on private electricity generation was blocked in the Supreme Court. That would have been unimaginable under the PRI.

There is also a slow, nearly invisible metamorphosis in the lower levels of government, some of which began before Mr Fox took office. Officials charged with cutting bureaucracy are working on reducing the paperwork needed to start a business. Rather than wait for a promised freedom-of-information law, they are putting more documents on the Internet. They are chipping away at the rules and procedures for civil servants, which fill a book over 1,200 pages long. “It's like plumbing,” says Carlos Arce, who heads the economy ministry's regulatory-improvement commission. “It's dirty, it's nasty. You put your hand in and you don't know what will come out. Not everyone likes to do it.”

Thanks to this sort of replumbing, though, information now flows more freely between government ministries, which used to guard it jealously even from each other. People move more freely, too. Under the PRI, says a mid-level official, you had to follow your boss loyally wherever he went, according to political tides. Now that many of the new bosses are outsiders who lack lots of hangers-on, he says he has had several job offers from other departments. Promotion is starting to depend on performance—the beginnings of a career civil service.

These are the kinds of changes that are bringing Mexico, inch by inch, out of the PRI era. And, like the bus company's sudden preference for legal videos, many are happening without Mr Fox's help. What's new in the new Mexico? It's what Mexicans as a whole are doing.

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Argentina's opposition

Political Viagra

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Carlos Menem's release has triggered a leadership battle

Reuters

Reheating a stale act

THE election is not until 2003. But such are the troubles of Argentina's economy and of President Fernando de la Rua that there is little doubt that his successor will come from the opposition Peronists. But which Peronist? The Supreme Court's decision last week to quash arms-smuggling charges against Carlos Menem, Mr de la Rua's predecessor, freeing him from five months of house arrest, has unleashed a fierce struggle for his party's candidacy.

Mr Menem at once launched his own bid. He was soon followed by Carlos Ruckauf, the governor of Buenos Aires province. Mr Menem is still the titular head of the Justicialist Party (the Peronists). To try to retake control, he convened its national council. But under 10% of the party's congressmen are still loyal to him, and most of its leaders boycotted the meeting.

Mr Menem is discredited both by the stench of corruption that swirled around his ten-year rule and by his legacy of public debt, which has left Mr de la Rua's government on the brink of default. But, armed with a new wife half his 71 years, he is not quite finished. “Whatever you think of him, he is the only real leader in Argentina. Everyone's scared of him,” says Hugo Haime, a political analyst. In Mr Haime's polling of Peronist sympathisers, Mr Menem's 17% approval rating is broadly similar to that of his rivals. He is unlikely to get the nomination, but he has influence.

He benefits, too, from Peronism's fragmentation. Lacking ideology and, since Mr Menem's decline, an undisputed leader, the party is likely to see a series of shifting pacts between its barons, concerned mainly with their short-term personal interests. This is just the sort of situation in which Mr Menem excels.

In an effort to block the ex-president, Mr Ruckauf and another contender, Jose Manuel de la Sota, the governor of Cordoba, are trying to agree on rules for the selection procedure. They would like this to be brought forward, before their provinces are utterly bust. Meanwhile, Eduardo Duhalde, who blames Mr Menem for his defeat by Mr de la Rua in 1999 and who is now Mr Ruckauf's political patron, is trying to seize control of the party machinery.

Publicly, the government regards Mr Menem's release with indifference. But the justice ministry had done little to prosecute the case; indeed, behind the scenes, government operators had lobbied the court to dismiss the charges. So, with the opposition now gripped by infighting, has Mr de la Rua scored a rare political victory? Yes and no. Mr Menem will work to head off efforts by factions in his party to ease Mr de la Rua out early. (Mr Menem would be constitutionally banned from running if the election were brought forward.)

But Mr de la Rua, who was elected in part to tackle corruption, may have lost another shred of his remaining credibility. And Mr Menem's return is forcing the Peronists at last to digest their 1999 defeat. That could leave them stronger—and accelerate their search for a new leader.

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Honduras's election

A yawn no longer

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The voters have given democracy a boost

NOBODY takes much notice of Honduras, a small and poor country. An election last month in Nicaragua, its even poorer neighbour, briefly distracted American officials from the war in Afghanistan to work (successfully) against victory for former left-wing revolutionaries. The election in Honduras on November 25th barely raised a yawn.

AP

Can Maduro brighten things up

That is a pity. Not only was the turnout high, but in a country of strong party loyalties Honduras's voters made a decisive break with tradition. They chose the National Party over the ruling Liberal Party for only the second time in the 20 years since democracy was restored in 1981 after decades of military rule.

Ricardo Maduro, the victor, promised a crackdown on violent crime (his son died in a kidnap attempt in 1997). He also wants privatisation, and other reforms favoured by the IMF. Mr Maduro, a former central-bank governor and now a businessman, did not differ greatly on the issues with Rafael Pineda Ponce, the defeated Liberal candidate. But he prepared a detailed platform, whereas Mr Pineda, a veteran politician and the leader of Congress, was vague.

“People voted for the best candidate, not according to traditional party preference,” says Juan Ramon Martinez, a Honduran political analyst. In voting for a new Congress, which for the first time was on a separate ballot slip, smaller parties seem to have done well. For the first time, neither the National Party nor the Liberals are likely to have a majority. Both results suggest that the two big parties are losing their stranglehold.

Will Mr Maduro manage to implement his ambitious plans for reform? Unlike his opponent, he is not a party insider. His party has some powerful conservative vested interests. But whether or not he keeps his promises, politics in Honduras will not be the same again.

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Chile's economy

In search of new tricks

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Chile could do more to become less dependent on copper

Get article background

THE market price of copper has fallen this year to its lowest in fifteen years, making it cheaper in real terms than it was during the Great Depression of the 1930s. That is bad news for Chile, the world's largest producer. It is Latin America's star economy, having grown at an average annual rate of 7.6% in the ten years to 1998, and claims to lead the region in free-market economic reform. But it remains dangerously dependent on the metal (see chart).

Of Chile's total exports, worth $18.2 billion last year, copper accounted for $7.3 billion, or two-fifths. The price of copper averaged 82 cents a pound last year, but the world economy's troubles brought it down to 60 cents last month. Largely because of that, Chile is suffering an economic slowdown: GDP is set to grow by just 3.1% this year and 2.2% next, according to the Economist Intelligence Unit, a sister company of *The Economist*. And Chileans are now worrying about whether they should, or could, diversify a bit more.

Matters might be far worse. Chile's fortunes have risen and fallen with the copper price since it gained independence in 1818. But several changes in recent decades have reduced its vulnerability to swings in the price of the metal. Reforms imposed by the military dictatorship of Augusto Pinochet in the 1970s and 1980s included the fostering by the state of other export industries, including pulp and paper, fruit, wine and farmed fish. Copper's share of total exports has fallen by half since the early 1970s, when plunging prices for the metal brought deep recession.

Moreover, Chile's copper industry is itself more efficient than it used to be. Although General Pinochet preserved Codelco, the state-owned mining giant, he also readmitted foreign mining companies. Finding copper deposits and then developing a mine can take more than a decade. It was not until the 1990s that the presence of efficient foreign miners forced Codelco to shape up, cutting its production costs and putting it in a better position to withstand low copper prices.

An additional bonus is that, unusually for Latin America, Chile's government operates a counter-cyclical fiscal policy. Since 1989, whenever the copper price has risen above what is presumed to be its long-term average, the government has put part of its earnings from Codelco into a stabilisation fund. When the price falls below the trend, the government can draw on the fund to make up its revenue shortfall.

Chile's sound finances—the country has an investment-grade credit rating—meant that the government had no difficulty in topping up the fund through a recent international bond issue, despite the pall cast over Latin American credit markets by Argentina's near-default. Worries about Argentina, combined with copper's weakness, caused Chile's peso to lose a fifth of its value between January and October, before strengthening last month.

Not bad, but might be better. The share of copper in total exports stopped falling in the early 1990s. That coincided with a slowdown in the pace of economic reform, after democracy had been restored in 1990. Only now is Chile freeing its capital markets, for example. Until this year, foreigners had to seek permission to invest in the country and pay a special tax.

But a labour law approved this year raises the cost of laying workers off. Employers complain that this will inhibit job growth and keep unemployment stuck at its current 10%. A bill to cut the stifling bureaucracy that inhibits the growth of new businesses is making slow progress in Congress. It takes 18 months and 72 procedures to get permission to open a supermarket, says Leonardo Suarez of Larrain Vial, a stockbroker.

Chile's centre-left government would like more foreign companies to open plants. It is still smarting from losing an Intel microchip plant to Costa Rica in 1996. Chile now intends to offer tax breaks to foreign investors. It might be better to promote the country's advantages as a place to do business, argues Felipe Larrain, of Santiago's Catholic University. These include low taxes and import tariffs, political stability and good universities.

But technical education is poor: “Hiring managers is no problem here but just try finding someone to operate a machine tool,” says Alexander Newman, president of Electromecanica, an engineering company. Cheaper training schemes are needed, and an effort to change the attitudes of parents and teachers, who instil in youngsters the idea that office work, however humble, carries more prestige than being a technician, however well paid.

A more direct way of reducing Chile's exposure to copper would be to sell Codelco, investing the proceeds in broadening the economy further. But privatisation is tricky—not least because the armed forces receive a slice of Codelco's revenues. Better to start by selling a minority stake, says Juan Villarzu, Codelco's boss.

In the 1980s, copper seemed likely to be displaced by optical fibre. But the boom in electronics meant that demand increased. Mr Villarzu, as might be expected of the world's top copper salesman, is convinced that the metal has a shiny future. In 1990, cars contained an average of 12kg (26lb) of copper. Now, the typical model is stuffed with electronics and has more than 17kg of copper, he points out. That is another reason why Chile's copper problem is one that many of its less fortunate neighbours would love to have. On the other hand, the biggest threat facing Chile is its temptation to rest on its copper-plated laurels.

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Taiwan and China

China learns to live with Chen

Nov 29th 2001 | TAIPEI
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AP

A striking absence of the usual Chinese sabre-rattling as Taiwan goes to the polls

Get article background

CHINA'S communists seem to have learned a lesson. As Taiwan prepared for a parliamentary election on December 1st, the leadership in Beijing refrained from its usual practice of trying to intimidate Taiwan's voters into supporting candidates who favoured the reunification of mainland and island. Even though the election is likely to strengthen the hand of Taiwan's independence-leaning president, Chen Shui-bian, China has been keeping remarkably quiet.

Mr Chen may have little to boast about on the economic front: Taiwan has slid into the deepest recession in its history since he was elected last year. But contrary to the dire warnings issued by parliament's largest party, the Kuomintang (KMT), in the approach to last year's presidential poll, relations between Taiwan and China have remained stable, if cool, under Mr Chen's leadership. In public, China is contemptuous of Mr Chen, but he has not turned out quite as bad as China feared.

China's tolerant attitude is striking, given its generally tougher stance since September 11th towards what it regards as separatist challenges, particularly in its far-western region of Xinjiang. As far as Taiwan is concerned, however, China seems to believe its interests are best served by remaining aloof. With good reason: previous efforts to influence Taiwanese elections with bellicose threats and war games in the Taiwan Strait badly backfired.

And despite signs of greater warmth between China and America since September 11th, the United States has signalled that it remains just as committed to preserving Taiwan's defence. Last week, the American navy said seven American and foreign companies had expressed interest in building eight diesel submarines for Taiwan. “This is very much a symbolic assurance that the United States has not forgotten Taiwan,” argues Andrew Yang, a military analyst in Taipei. Taiwan's foreign minister, Tien Hung-mao, says that “sources” in West European countries—which he declines to name—have offered to co-operate in the venture. If they do, that will infuriate the Chinese.

China, however, shows no sign of slackening its efforts to acquire the military capability to force Taiwan to reunify some day. During the summer it conducted exercises in the Taiwan Strait. Mr Yang says China's aim was to improve its readiness to deter any intervention by American aircraft carriers in a conflict in the strait, as well as to practise precision strikes against Taiwanese targets. But, at the same time, China has ceased repeating the threats it made before the March 2000 election that it would use force if Taiwan kept resisting reunification talks, as seemed probable under Mr Chen, who won anyway.

On the face of it, China would appear to be heading for disappointment on December 1st. One virtually certain outcome of the election is that the KMT will lose its position as the majority party in the legislature for the first time since it fled to the island from the Chinese mainland at the end of the Chinese civil war in 1949. The KMT, unlike President Chen's Democratic Progressive Party (DPP), espouses some form of eventual reunification with China. While pointedly shunning the DPP, Chinese officials have welcomed visiting KMT and other like-minded politicians with open arms.

But the DPP will not be able to win a majority on its own, and any coalition may prove unstable. On mainland policy, Mr Chen will strive hard for a cross-party consensus. Although the president is no advocate of reunification, Mr Tien, the foreign minister, says that Mr Chen has made statements that could be seen by the Chinese as repudiating the separatist movement. “They don't really think that President Chen Shui-bian is promoting separatism. In spite of what they say rhetorically, in substance they feel that there is no sense of urgency,” says Mr Tien.

With backing from the KMT, Mr Chen has overhauled the island's policy toward contacts with the mainland. In recent weeks he has abolished the $50m ceiling on Taiwanese investment in China, announced that Chinese nationals will be allowed to visit Taiwan for the first time as tourists (albeit only if they are resident outside China) and called on the mainland to discuss direct transport, postal and trade links between the two countries.

Limited transport links were first allowed earlier this year between the mainland and the tiny Taiwanese islands of Kinmen and Matsu. All the talk now is about extending those to the main island of Taiwan itself, something that China has demanded for years. Taiwan is also lifting its ban on the production of notebook computers and certain other high-tech items by Taiwanese companies in China.

Taiwanese officials hope the admission of Taiwan and China to the World Trade Organisation (WTO), approved last month, will promote dialogue between the two countries on economic issues including direct links. But China insists Taiwan must accept in advance that there is only “one China” before it will talk. Mr Chen so far has agreed to talk only about the future possibility of “one China”.

A vice-chairman of Taiwan's cabinet-level Mainland Affairs Council, Lin Chong-Pin, says a limited opportunity for dialogue will emerge between the election and next summer, when China will become absorbed in preparations for its five-yearly Communist Party congress. “We should not underestimate Beijing's ability to change tactics,” he says.

But China already appears too preoccupied with issues concerning its leadership succession, the impact of WTO membership and the preservation of social stability to start making bold moves towards reconciliation—or indeed towards confrontation—with Taiwan. “The Chinese have got more from Chen Shui-bian than they were expecting. They are quite happy with the situation,” says Jean-Pierre Cabestan of the French Centre for the Study of Contemporary China.

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Mad-cow disease in Japan

High steaks

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The scare intensifies

THEY may not treat it quite as reverently as rice, but the Japanese have always taken pride in their home-grown beef. Farmers pamper cows by giving them massages and beer. The best sort of beef, the legendary Kobe kind, little of which is ever allowed to find its way abroad, is talked of in reverential tones.

No more. Ever since September, when a cow in Chiba prefecture was found to be infected with BSE, consumers have been shunning beef. Despite frantic efforts to reassure, McDonald's and other restaurants specialising in beef have seen sales plunge. Wholesale prices for beef have dropped over 50%. At least six other countries, including South Korea and America, have banned Japanese beef imports.

Though few people can have believed that there was only one infected cow in the whole country, the discovery of a second in Hokkaido, Japan's northern island, last week, still caused a stir. The authorities suspect the beast had eaten cattle feed that may have had infected meat and bone meal (MBM) mixed into it. MBM, which is banned in Europe, is made from the carcasses of ruminants, and the resultant feeding of cows to other cows is almost certainly how the BSE epidemic began in Britain. Exactly how the first cow was infected remains unclear.

Many blame the government for the speed with which consumers have turned away from beef. Even after the outbreaks of BSE in Britain in the 1990s, the Japanese agriculture ministry continued to let farmers feed MBM to cows. Earlier this year, it tried to hush up a study by the European Union that found Japan a relatively high-risk country for BSE. Its old rivalry with the health ministry is now leading to confusion about the way cows should be tested for BSE.

To make matters worse, the agriculture ministry's response to the first discovery was a shambles. It accidentally let the remains of the cow re-enter the food chain, by failing to stop it from being turned into MBM, possibly infecting cow number two—even as a ministry official was reassuring the public that the cow had been incinerated. Afterwards, his boss explained that the official had made the wrong assumption because he had “watched too much television”, and seen too much footage of cows being burnt in Britain.

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Sri Lanka's election

Voting in blood

Nov 29th 2001 | COLOMBO
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Violence mars the ballot

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AP

Kumaratunga hopes for a better result

AT LEAST ten keen party workers will not be voting in Sri Lanka's general election on December 5th. They are dead, the victims of violence in the bitterly contested fight. So far, some 1,300 incidents involving violence have been reported to the police since parliament was dissolved on October 11th. They include an attempt by a suicide bomber to kill the prime minister, Ratnasiri Wickramanayke. He escaped, but five people were killed.

This is happening in a country where three-quarters of the population are Buddhists, followers of a religion that seeks to promote gentleness. But 18 years of civil war have to some degree brutalised the population. Some Sri Lankans blame the president, Chandrika Kumaratunga, for the extent of the violence. Her People's Alliance, they say, has not shown the restraint expected of a governing party.

Despite the turmoil of the civil-war years, Sri Lanka has managed to remain a democracy, albeit a flawed one. As in past elections, vote-rigging is expected to be common, partly as a result of the country's diaspora. Of the population of 19m, about 12m are entitled to vote. However, some 2m are spread around the world, most of them in menial jobs, notably in the Middle East, but some as refugees of one kind or another. The votes of these exiles may come to be cast by others at home, with or without their knowledge.

Nor is the result likely to be a clear-cut win for either the People's Alliance or the United National Front, the main opposition grouping. The country's system of proportional representation is thought to be suitable for a multi-caste, multi-religious, multiracial country. But even if it is, it is unlikely to produce a decisive result. In a hung parliament, the king-maker is likely to be the Janatha Vimukthi Peramuna (JVP), which led insurgencies in 1971 and 1987 but has since been converted to democracy. The JVP represents the downtrodden rural poor, and is believed to be supported by many foot-soldiers of Sri Lanka's armed forces who are fighting the separatist Tamil Tigers in the north-east of the island. Rejecting its own murderous past, it has won praise for condemning violence in the election campaign.

The election was called when it became clear that the People's Alliance was in danger of losing its majority in parliament. Stories were circulating of corruption among its ranks. Neither it nor the president had been able to honour their promise of ending the civil war. But the United National Front of Ranil Wickremesinghe does not inspire that much confidence. It is a loose alliance of Sinhalese, Tamil and Muslim parties, forged with the sole aim of ousting the government. What will happen should it form the next government is a matter for speculation.

The result of the general election will not directly affect the executive presidency of Mrs Kumaratunga. The president is elected separately. But the outcome of the election could be a hostile parliament and a prime minister opposed to her policies. Such a situation would test all of Mrs Kumaratunga's considerable political skill.

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Nepal's insurgency

Comrade Awesome

Nov 29th 2001
From The Economist print edition

Maoists launch their fiercest attack

A SYMPTOM of Nepal's backwardness is that it has one of the few remaining communist insurgencies left in the world, and it seems to be growing more serious. On November 25th, communists attacked police and army posts across Nepal, killing at least 100 people. It was the fiercest attack since the insurgency started in 1996, and broke a truce that had been agreed on in July. The government declared a state of emergency and asked for outside help—"from wherever it comes", said an obviously desperate minister.

AP

The latest tourist attraction

The Communist Party of Nepal (Maoist) is believed to have between 5,000 and 10,000 armed supporters. The range of the estimate is wide because no one in the government really knows, but it is assumed that the party has some support in most towns and villages throughout Nepal. Its leader is called Comrade Prachanda, which roughly translates as "Awesome". His main aim, he says, is to replace the constitutional monarchy with a communist republic.

Until now, the government has been reluctant to send its army against the rebels, for fear of making things worse, and has left the task to the police. But after this week's attack soldiers were deployed in the mountainous Solukhumbu district, where the insurgents are believed to be strong. However, the army has little experience of guerrilla warfare. Many of its 45,000 men, including its formidable Gurkhas, were abroad at the time of the attack, helping out with United Nations peacekeeping efforts around the world. Nepal has no air force, although the army has a few helicopters. The government told its large neighbour India this week that it was short of most items of military equipment, including ammunition.

India will be keen to help Nepal. The rebels are believed to have links with leftist groups in the Indian border states of West Bengal and Bihar. Like Comrade Prachanda, Indian leftists seek to win supporters by calling for land reform. The Indian government said it was tightening security along its border with Nepal. China, Nepal's other big neighbour, will probably ignore this week's events. Its semi-capitalist government regards militant "Maoism" with distaste, even though the originator is formally revered. The United States may help. Nepal's prime minister, Sher Bahadur Deuba, said in a broadcast on November 26th that the rebels were "terrorists", perhaps hoping that the evocative word would catch the ear of someone powerful in distant Washington.

However, despite the growing violence of the communist attacks, Nepal seems likely to remain stable. King Gyanendra, who took the throne after a palace massacre in June wiped out most of the royal family, seems to be gaining popularity. In a population of 23m, the rebels' numbers are not great. If the army

brings home its peacekeepers and they are taught a few new tricks, they should be able to contain the rebels.

That said, the only reliable path of peace in Nepal is to end its widespread poverty. More than a third of the population live on the equivalent of less than $1 a day, making them receptive to the message of the communists. The surprising thing is that they do not have more support.

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Suicide in China

The horrible exception

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A former taboo is at last being discussed

A QUIET revolution has been unfolding in China. At the third national conference on mental health, held in Beijing last month, government officials openly admitted that, with 250,000 victims every year, suicide was a major national problem. A decade ago suicide statistics were, literally, a state secret. Today the media often report on the issue, and national get-togethers are organised to tackle it.

People kill themselves everywhere in the world, but in China, unlike anywhere else, more women take their own lives than men. According to the WHO, suicide is now a leading cause of death for young women in rural China. China makes up 21% of the world population but accounts for over 55% of female suicides. Life for rural Chinese women can be dismal, often combining farm work, housework, abusive husbands or in-laws and forced sterilisation. Yet the lot of Chinese women is shared by many in other countries, who nonetheless do not resort to suicide in anything like the same proportions.

What may set Chinese women apart is the fact that their suicide attempts are more successful than in most places. Elsewhere, men who kill themselves outnumber their female counterparts by two to five, but a much larger proportion of women actually try to commit suicide. Because they usually choose less radical methods—pills rather than a gun or a rope—the great majority survive. In rural China, however, highly toxic pesticides are easily available, with the closest doctors or clinics often hours away. Less than one in ten attempted suicides are fatal in western countries. The proportion seems to be much higher in China's rural areas.

Jose Bertolote of the WHO points out that the rate of suicide fell dramatically in Britain when domestic gas and car exhausts were detoxified. So controlling access to pesticides might go a long way towards cutting the number of suicides in China. Better mental-health care would also help. Diagnosis and treatment of depression and other mental-health problems are embryonic at best, and often non-existent outside cities. The WHO has just started a programme to help the Chinese authorities develop a comprehensive mental-health-care policy and set up a support system in rural clinics.

This may deal with only a part of the problem, though. According to Arthur Kleinman of Harvard University, a much lower proportion of the women who commit suicide in China suffer from psychological disorders than in western countries, where suicide is closely related to depression, schizophrenia or some kind of addiction. In China, suicide may partly reflect a form of social protest. Chinese farmers have committed collective suicide to protest against laws preventing family burials in ancestral land, and women are reported to have collectively killed themselves rather than face arranged marriages. In the face of such a tradition, therapy and anti-depressants may prove useless.

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Malaysia

Mahathir's September bonus

Nov 29th 2001 | KOTA BAHRU
From The Economist print edition

Arguments over the Afghan war are crippling the opposition

THE war in Afghanistan may be making other Muslim leaders squirm, but it has been good for Mahathir Mohamad.While his counterparts face the unpalatable choice of alienating either America or their own citizens, Malaysia's veteran prime minister has managed to raise his stock with both, thanks to the intricacies of his country's racial politics. In other words, America's effort to force the Taliban from power is strengthening the Malaysian strongman's grip on it.

Just a few months ago, many commentators were writing Dr Mahathir off as a spent force. After 20 years in power, his popularity among his fellow Malay Muslims, the majority of the population, had long been in decline. Malaysia's economy, which had not yet recovered fully from its last recession in 1997, was faltering again. Dr Mahathir was resorting to increasingly drastic measures to shore up his government, from easing out his old friend and finance minister, Daim Zainuddin, to locking up members of opposition parties on vague conspiracy charges. The questions that had sapped his support at the past election—over the management of the economy, the independence of the judiciary and his own authoritarian tendencies—seemed more pertinent than ever. His riposte, that the Islamists of PAS, the main opposition party, were actually extremists in disguise, sounded irrelevant and implausible.

September 11th changed all that. American investigators suggested that Malaysia had been the source of an anthrax-laden letter, though they withdrew the claim later. A Malaysian Muslim, who had been arrested in Indonesia after the bomb he was carrying exploded, was accused of belonging to a global terrorist network. Fanatical-looking demonstrators turned up outside the American embassy in Kuala Lumpur during a PAS-led protest.

Dr Mahathir was happy to denounce extremism and share intelligence with America, since that fitted in nicely with his domestic agenda. George Bush was so pleased that he granted Dr Mahathir a long-withheld audience, despite his loud condemnation of the bombing of Afghanistan. But the biggest pay-off was on the home front. Amid the global uproar, Malaysia's Internal Security Act, under which some opposition figures had been detained without trial, no longer seemed so draconian. And the notion that PAS and the Taliban had something in common no longer seemed so improbable.

Malaysia does not allow opinion polls, so it is impossible to tell with any certainty how much Dr Mahathir's coalition, the National Front, has profited from this turn of events. But it is clear which way the wind is blowing. A small opposition party recently asked to rejoin the government, having defected from it a decade ago. Meanwhile, the Alternative Front, the main opposition alliance, is falling apart. The Democratic Action Party, which draws most of its support from Malaysia's Chinese minority, pulled out in September to avoid association with PAS's religious outpourings. The third member of the alliance, the Justice party or Keadilan, is embroiled in a public row about the influence of Islamists within its own ranks.

PAS has made things worse by rising to Dr Mahathir's bait and reiterating its demand for an Islamic state. Its leaders were even foolish enough to issue a call for *jihad* in support of Afghanistan. When asked if they meant that Malaysians should take up arms, they refused to rule it out.

In reality, PAS is more pragmatic than these statements suggest. Kelantan and Terengganu, the two states it runs, are a far cry from Afghanistan. In Kota Bahru, Kelantan's capital, children while away the Muslim fasting month of Ramadan watching rock videos in Internet cafes. Despite the fast, Chinese restaurateurs do a roaring trade, and their customers wash their food down with beer. PAS's edict that men and women should queue separately in supermarkets and sit apart in cinemas is observed mainly in the breach.

But Kelantan and Terengganu are poorer, more rural and less diverse than the rest of Malaysia. To make headway, PAS needs to win over more middle-class, urban Malays. High-minded Islamic talk or expressions of sympathy for Afghans may appeal to such voters, but any hint of actual instability seems to scare them off. And with Malaysia's Indian and Chinese minorities, which together make up 34% of the population, now thoroughly spooked, it is hard to imagine the opposition patching up its differences.

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The Palestinians and Hamas

Hamas has the people's heart

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AP

The Islamist movement's new strength and popularity

CAN Yasser Arafat stop the *intifada*? This is the precondition for a return to negotiations, says Israel. America agrees. Its latest envoys, William Burns and Anthony Zinni, have been instructed by Colin Powell, the secretary of state, to convince Mr Arafat that the uprising has become "mired in a quicksand of self-defeating violence" and must stop immediately.

It is a tall order. On November 27th, the day after the envoys arrived in the region, Palestinian gunmen killed three Israelis in two shooting sprees, one in Afula, a town in Israel, and the other in the Gaza strip. The attacks, condemned by the Palestinian Authority, were revenge for an Israeli army landmine that killed five Palestinian schoolchildren in Gaza last week, and for Israel's assassination on November 23rd of Hamas's notorious military leader, Mahmoud Abu Hanoud, whose funeral procession in Nablus is shown above.

Hamas claimed responsibility for the Gaza attack. The Afula operation was "first on a path of unified struggle until the Zionists leave our land," announced Islamic Jihad, the smaller and more extreme Islamist faction, in a joint statement with the al-Aqsa Brigades, a militia linked to Mr Arafat's mainstream Fatah movement.

This seditious unity makes it far harder for Mr Arafat to crack down on the Islamist organisations. It is true that he has managed to do so before. After a wave of suicide bombings in Israel in 1996, he went after Hamas root and branch, rounding up members, taking over their mosques, and reminding everybody who was boss.

But things have changed since then. In 1996 there was a functioning peace process; now it is in bloodied collapse. Then he had the active backing of Fatah. Now, as the Afula incident shows, many Fatah members collaborate with the Islamists. Then, his people, if not supporting him, were at least quiet. Now they are in ferment, outraged almost as much by the mismanagement of his regime as by the carnage of the past 14 months which has left 725 Palestinians dead (and 192 Israelis) and devastated their land and economy.

Above all, in 1996 Hamas was isolated and on the run. Now it is reinvigorated, drawing sustenance from the demise of peace, Fatah's disarray and general despair. The group's popularity has soared, reaching parity with Fatah's.

Martyrs and welfare workers

Hamas's suicide operations, which once were frowned on, now give it kudos. Most Palestinians view the killing of civilians in Israel as a legitimate response to Israel's killing of civilians in the West Bank and Gaza. Moreover, they appreciate the social work that Hamas charities are carrying out. In Gaza, where one in three workers is now without a job and one in two families is impoverished, its impressive welfare operation stands in stark contrast to the inefficiency and corruption that plague the Palestinian Authority's ministries. “The authority is rotten. Hamas is serious,” observes a secular Gazan.

But perhaps the most important reason for Hamas's new popularity is that in this *intifada*, unlike its predecessor in the late 1980s, the Islamist group has joined forces with other Palestinian factions, including Fatah, in what is becoming an unshakable national consensus. According to this, the *intifada* will continue until the Israeli occupiers “leave our land”. The consensus does not rule out ceasefires, but accepts them only if they serve national goals. It almost certainly rules out any return to the mass arrest of Islamist militants, whom most Palestinians see not only as “martyrs” but also as the real defenders of their towns, villages and refugee camps.

Mr Arafat's dilemma is acute. If he bows to America's demand that he must “arrest, prosecute and punish the perpetrators of terrorist acts”, he risks a violent confrontation with the armed factions, a fight that could bring the collapse of his own authority, personal and institutional.

But if he does not do so, and lets the *intifada* run free, he risks his very existence at the hands of an Israeli prime minister, Ariel Sharon, who, in effect, has already buried him. And he can expect little help from an American administration that is plainly fed up with a Palestinian leader who promises much but delivers little.

The only hope, say some Palestinians, is for America to recognise that Mr Arafat, mortally weak, can broker a ceasefire only with the consent of the Islamists, and on the basis of progress towards peace and immediate relief for his people. This would still call for the required “100% effort” from Mr Arafat. But it would also need real pressure on Mr Sharon. America should exert this pressure, says Khalil Shikaki, a Palestinian analyst, not out of affection for Mr Arafat but out of concern for what may come after him. “Hamas is already part of the Palestinian mainstream. One more year of the *intifada* and it will be the mainstream,” he predicts.

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Lebanon

How respectable is Hizbullah?

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EPA

Graduation day for Hizbullah's fighters

A terrorist group, say some. A political organisation, say others

THE Lebanese like to think of their country as Switzerland with a sea coast. Close one eye and the vision is true, complete with ski slopes and gleaming banks. But Lebanon also suffers from whopping debts, dangerous politics and a bad neighbourhood. Peace and prosperity are ever in reach, and ever driven back by gusts of misfortune and bursts of gunfire.

Given Lebanon's past, with its 15 years of civil war, 22 years of Israeli occupation in the south and 25 years of Syrian interference, the key to survival is maintaining confidence in the future. Always shaky, that confidence has been further battered since September 11th. The hardest blow came at the beginning of November, when the United States drew up a new list of “terrorist” groups which, it says, should be subject to financial sanctions, and Hizbullah, or the Party of God, a radical Lebanese Shia Muslim group, was included.

The listing faces Lebanon's government, and its banking industry, with an acute dilemma. Financiers would dearly love to trim the sails of Hizbullah, whose undimmed hostility to Israel perpetually risks a conflagration. The government desperately needs a clean bill of international financial health, if only to lower the cost of servicing its $26 billion debt, which currently devours a giddy 45% of the deeply red-tinged budget. In the words of a Beirut columnist, the country is thus “an ideal soft target” for American pressure.

Yet Lebanon's precarious political balance renders Hizbullah untouchable. It is not simply that the group has the backing of Syria, which remains the final arbiter in Lebanese affairs. Most Lebanese, and indeed most Arabs, simply do not regard Hizbullah as a terrorist organisation. During the civil war, it is true, it was engaged, like virtually every other Lebanese faction, in kidnapping and bombing civilians. It won a particular reputation for striking at western interests, pioneering the use of suicide attacks against targets such as the American and French embassies, and an American marine barracks in Beirut.

Hizbullah has also been linked, if somewhat tenuously, to atrocities abroad since the civil war ended in 1991, in particular the bombing of a Jewish centre in Buenos Aires. Rogue operatives may also have sponsored an attack on American servicemen in Saudi Arabia in 1997.

For the most part, though, and certainly in recent years, the group has been scrupulous in sticking to what most Lebanese regard as legitimate targets. Hizbullah is credited with making Israel's occupation of southern Lebanon so prickly that it was forced to withdraw its forces in May 2000. Since then, the militia

has concentrated all its armed activities on two objectives: keeping the heat on Shabaa Farms, a tiny, disputed enclave in the Israeli-occupied Golan Heights; and securing the release of people still held captive in Israeli jails.

Other Lebanese factions, and particularly Christian ones, are chagrined that, unlike them, Hizbullah has been allowed to keep its arms. These include, say the Israelis, 8,000 Katyusha rockets and artillery with a 60km (38-mile) range.

Yet even the group's detractors respect the efficiency of its schools, clinics and orphanages, the slickness of its radio and satellite television channels, and the grassroots clout of its politicians, 11 of whom are members of parliament. Hizbullah could have won more of the 128 parliamentary seats, and indeed did sweep recent municipal polls in the Shia heartland south of Beirut, but has chosen to defer, for tactical reasons, to the Amal party, the Shia group most closely aligned with Syria.

Hizbullah proudly supports other Islamist “resistance” groups, such as Hamas and Islamic Jihad in Palestine. But it is not driven by Islamic fundamentalism, and its leaders make it clear that it is ideologically distinct from Osama bin Laden's brand of international terrorism. Its spiritual guide, Sheikh Mohammed Hussein Fadlallah, was one of the first Muslim clerics to condemn the September attacks on America. Far from backing the call for *jihad*, the party's secretary-general, Hassan Nasrallah, has warned Muslims to avoid the “Zionist trap” of believing that they are pitted against Christianity in a religious war.

The Lebanese authorities would find it difficult to impound Hizbullah's finances, even if they had a will to. For the time being, however, it appears that America is not pushing too hard. Government sources in Beirut say they are engaged in “dialogue, not confrontation”. They note that America has yet to raise the issue with the United Nations, which would be a necessary precursor to sanctions. Lebanon has also scored points by cracking down on what it considers *bona fide* terrorists, rounding up at least one group with known links to al-Qaeda.

Beirut bankers, meanwhile, have been relieved by better news. Lebanon is expected to sign a free-trade agreement with Europe within weeks. The budget deficit will shrink with the introduction of a value-added tax next year. The energetic prime minister, Rafik Hariri, has charmed rich Gulf Arabs into big investments, including a $1 billion injection of deposits in the central bank to shore up Lebanon's reserves. For the time being, the Israeli warplanes that regularly buzz the country remain more of a nuisance than a threat.

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Zambia's elections

Cunning timing

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Elections later this month will benefit the ruling party, and current president

AP

Merry Christmas, Mr Chiluba

FEW Zambians are pleased with the Christmas present they have just been offered. After months of delay, the outgoing president, Frederick Chiluba, has called presidential, parliamentary and local elections for December 27th. But it may be precisely what Levy Mwanawasa, the ruling party's candidate and Mr Chiluba's choice as successor, thought he wanted.

The opposition, which is split into more than ten factions, is deeply suspicious of Mr Chiluba's timing. Zambia is predominantly Christian and many people are likely to be visiting their families and unable to vote. Even more important, the end of December is in the middle of the long rainy season. Rain is already falling across the country, and many rural areas will soon be inaccessible because of floods and thick mud. It will be hard for candidates to campaign and for voters to vote. And many farmers will be too busy planting their fields to bother with the ballot box.

All this points to a low turnout, which will help the ruling Movement for Multiparty Democracy (MMD), especially in the all-important race for the presidency. Already opposition politicians are crying foul. Among other things, they accuse Mr Mwanawasa of planning to make widespread, and illegal, use of state-owned helicopters and four-wheel-drive cars and trucks to campaign in soggy areas and to ferry supporters to the polls.

Even so, the MMD and Mr Mwanawasa, who is widely seen as Mr Chiluba's stooge, will need all the help they can get. The president split his party after a clumsy bid to change the constitution earlier this year so that he could run for a third term. More than 30 ministers and members of parliament, including two vice-presidents, defected to existing opposition groups, or set up their own parties for the election. They now talk, shamelessly, of a decade of government failure, corruption, agriculture in crisis and a health system tottering as AIDS spreads to frightening levels. Despite economic growth of around 4% a year—the result of painful reforms, says the government—the country is blighted by growing poverty and unemployment.

The fractious opposition would have a better chance of winning the presidency if it could agree on a common candidate. Instead, at least four serious opposition candidates are competing in the first-past-the-post race. Christon Tembo, a former vice-president, is the best known and his party, the Forum for Democracy and Development, is gaining popularity. But he was removed from his job as vice-president only in May, and is tainted with the government's poor performance. Some parties did try to cobble together a coalition earlier this year, but could not agree on who should run for president.

If the anti-government vote is split, Mr Mwanawasa is likely to slip into the president's office, albeit with a minority share of the few votes cast. His mandate will be weak, and this could have two effects. Parliament, which has been treated with contempt by Mr Chiluba, who put it into recess for seven months this year and then allowed a four-day session, will be better able to stand up to the president.

But, at the same time, Mr Chiluba's role as the power behind the throne could be strengthened. The outgoing president has made sure that, whatever the result of the elections, he remains in charge of the MMD. If the president is weak, the party leader will be that much stronger. Not a bad present to wrap up for yourself.

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South African politics

Creeping back into bed

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The party that ruled in apartheid days rejoins the government

IS IT a boost for multiracial co-operation, or an example of crude politicking? Perhaps both. This week, after a month of talks, the ruling African National Congress (ANC) and the New National Party (NNP) announced their engagement. They will co-operate “in national government [and] in all areas of South Africa's political life.” After five years in opposition, the party of apartheid, which reserved the vote for whites alone, is back in government.

The NNP, which drew just 7% of the vote in the 1999 election and was widely considered a spent force, has crept back from the dead. In October, Marthinus van Schalkwyk, its leader, walked out of his opposition alliance with the Democratic Party after a row over the sacking of the mayor of Cape Town. Details have not been made public, but he now seems to have talked his way into Thabo Mbeki's large cabinet. He will probably have two deputy ministers, plus posts in several provincial cabinets. This reverses a decision made by his tetchy predecessor, F.W. de Klerk, who left a government of national unity with the ANC in 1996.

The ANC is likely to gain more than the Nationalists from the new arrangement. It has skilfully taken advantage of the divided opposition, and the NNP can expect to have little influence on policy, despite its grand statements this week on tackling poverty and AIDS. By contrast, the ANC will, for the first time, have a share of power in the Western Cape. Plainly, the opposition is even weaker than it was before—which is good for the ANC, though not necessarily for the country.

In the longer term, the marriage could hurt Mr van Schalkwyk. His white voters may well desert to the opposition in the 2004 election, and his Coloured (mixed race) voters could plump for the ANC. A constitutional amendment, due early next year, will make jumping ship easier by allowing politicians at national, provincial and local levels to switch their party loyalty without losing their seats. But the Nationalists have survived tales of their demise before, and few South Africans are quite ready to write them off again.

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Ramadan

Women's work

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After the fast comes the feast

Get article background

“YES, Ramadan is hard on Moroccan women,” agrees Latifa, a fashionable 20-year-old hanging out with her friends in Agdal, a smart middle-class part of Rabat. After the daily dawn-to-dusk fast, comes the feast, and even the most career-minded single women are dragooned back into the kitchen to help prepare the time-consuming *harira* bean soup and the traditional pancakes and sweets: *melaoui*, *baghira*, *chebbakia*, *sfouf*.

It's like a month of Christmases, commented a sympathetic westerner. Manicured fingers become caloused from pounding. Malika, a literature student, recalls the time when she wanted to protect her hands with rubber gloves. “What if the neighbours see?” her scandalised mother remonstrated.

Yet those culinary hours have compensations, enabling a middle-class girl to polish the traditional skills that help towards finding a suitable husband. Indeed, Latifa and her friends admit to “adoring” Ramadan's “completely different atmosphere” which allows them, once the eating is done, to go out with their friends at night. And does she smoke during the holy month? An ad-man's dream, she flicks her wrist to show the pack of Marlboros hidden up the cuff of her denim jacket.

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Russia's reforms

Lurching ahead

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While President Vladimir Putin wows the West, Russia is changing, slowly

Get article background

FOREIGN policy: splendid but fragile. Economic reform: cautiously encouraging. Democracy: still wobbly. The stirrings of public spirit: small but detectable. That would crudely sum up the remarkable but contradictory changes in Russia, some of them apparent since September 11th.

The best news is that, for whatever reason, President Vladimir Putin is plotting a course that broadly suits the West and would have seemed barely imaginable only three months ago. There is little talk these days of a “strategic partnership” with China or of North Korea's dictator, Kim Jong Il, as a “thoroughly modern man”, or even of that old Soviet tactic of trying to wean Europe away from its alliance with America. Instead, Russia is itself fast cosying up to the United States.

Mr Putin has learned to woo foreign politicians and journalists alike. Harangues and bluster have given way to a relaxed, articulate, convincing manner, backed by a formidable command of detail, and even salted with the occasional dry joke. He is winning some new friends at home, too. At a state-sponsored “civil forum” last week for voluntary outfits, even some diehard human-rights campaigners were impressed by the authorities' willingness at least to listen to them.

Recruiting foreign opinion is not just a matter of patter. After September 11th Mr Putin acted speedily and decisively to portray Russia as a trustworthy partner. He gave unstinting support, both diplomatic and practical, to America's war in Afghanistan; during past American interventions, in Yugoslavia and the Gulf, Russia's stance was querulous or outright hostile. Mr Putin has also moved quickly to tidy up other loose ends, from closing military bases abroad to opening negotiations to end the war in Chechnya.

One big reason for the change is that Mr Putin genuinely loathes what he calls “Islamic terrorism”. Whatever Russia's differences with the West—over missiles or Yugoslavia—they are mere nuances compared with what he sees as a shared threat from Russia's south. In the previous era of grumpy indecision, Russia sat impotently on the global sidelines, flirting with countries poorer and nastier than itself, while its western neighbours once under Russia's sway, such as Poland and Estonia, raced away to rejoin the modern world.

Now Mr Putin has placed his chips. He wants a strong, modern Russia, and that means money and know-how from the West, whatever the short-term cost in political concessions. Generals and other hawks are uneasy or outright angry but their protests get nowhere. The press and opposition parties are docile.

Mr Putin's other main achievement is that Russia no longer feels like a disintegrating country. The Kremlin is plainly in charge, both at the centre and in the provinces. The president has humbled most of the tycoon-politicians who infested public life in the Yeltsin era. There is a steady government, a growing economy, a balanced budget and low inflation. Some big reforms, to simplify taxes and free the market in urban land, should soon reap at least some benefits. Mr Putin is popular.

The Putin performance sheet

Policy/reform	Importance	Resistance	Progress so far
Justice system	●●●●●	●●●●●	Goodish new laws, bad old habits
Bureaucracy	●●●●●	●●●●●	No big changes yet
Tax	●●●●	●●●	Flat rates introduced, fearsome bureaucracy remains
Customs system	●●●●	●●●●	Crooked officials and their friends yielding very slowly
Banking	●●●●	●●●●	Reform blocked by Central Bank
Armed forces	●●●	●●●●	Putin's pal is minister but soldiery still ill-paid and useless
Household charges*	●●●	●●●●●	Painful price rises promised soon
Land	●●●	●●	Only urban market freed, open sale of farmland promised
Centralisation	●●●	●●●	Disintegration checked but regions no better run
Tycoons	●●	●●●	Stroppy old guard out, docile new guard in
Foreign affairs	●●	●●	Shiny new image, broadly pro-western

Source: *The Economist* *Heating, utilities, rent and maintenance costs

And yet the really difficult reforms—of the bureaucracy, of the military and security empires, of state-run heating and housing—still lie ahead. Even where good laws have been passed, most of them have yet to bite. And economic growth, fuelled by the high oil price and the effects of the 1998 devaluation, is tailing off again. Last year it was more than 8%; this year it may be less than 5%.

The good news is that the past two years have created a cushion, of both cash and credibility. That should make borrowing money from abroad cheaper and easier (see article). The country can survive a year or so of lower oil prices with only modest belt-tightening. Only if oil falls below $12 for some time will the economy stop growing.

Many steppes still to go

In the medium run, though, things still look pretty bleak. Around 40% of Russian businesses make a loss, even after the two best years in the country's economic history. Imports are shooting up, exports (raw materials aside) are still pitifully few. Most factories are direly managed. Their machinery on average is 16 years old, roughly three times the figure in the West. Government interferes very widely. The crony-ridden, state-dominated banking system keeps old businesses going but chokes off capital from new ones. Small firms, the backbone of most strong economies, in Russia are becoming fewer.

The bureaucracy and the corrupt overlap between politics and business are still the country's biggest problems. The most encouraging signs here lie in the work of the Audit Chamber, a government watchdog run by a former prime minister, Sergei Stepashin. Despite government resistance, he has been poking around some of the country's most lucrative state bodies: those dealing with fisheries, customs, railways, natural resources, the press and civil emergencies. All in all, billions of dollars have gone adrift, he says. A clutch of bigwigs are under investigation.

Another bit of the government is slowly trying to get rid of the red tape that fosters corruption and incompetence. The number of licences and other bits of paper that businesses need has shrunk. After next summer it should become easier to register a new company.

Reform of the justice system is the single biggest condition for real change. Despite a bunch of new laws passed last week, it will be very slow. Judges will be better paid and easier to sack, but finding and training good ones will take years. The prosecutor's office remains notably unreformed, as are other powerful agencies, including the FSB (the domestic security service), the tax police, the interior ministry and the armed forces. For all the talk of legality, state authorities still do pretty much as they want, including using the law against political opponents and the independent media. This week TV6, the last

big opposition television station left, looked set to succumb to a state-backed squeeze.

More helpful nudges are coming from elsewhere. A new code on corporate governance may make big business a little more open and law-abiding. Some liberal politicians are planning to introduce a law on freedom of information next year.

But two big things are still missing. One is a commitment to clean government at the top. The suspicion remains that, as the old team gets whacked, a new lot takes over. Many of Mr Putin's old St Petersburg chums seem to be doing very well for themselves; so do a bunch of other well-connected tycoons.

The other big shortage is of public spirit. Most Russians would still rather pay up or shut up than kick up a fuss. Few think that the latest kerfuffle over corruption or working for pressure-groups will improve their own lives. Still, Elena Panfilova, who runs Russia's branch of Transparency International, an anti-corruption lobby, thinks that time is on the side of good government. “It is the logic of history,” she says. “But it will take a generation.”

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Gypsy children

Go to school—and stay there

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There is a small glint of hope that more Gypsy children may be educated

A THIRD of Europe's Gypsy children never attend school, according to findings put out this week by Save the Children, a charity. Most of the rest are shunted off into special schools for the mentally disabled or else drop out of normal school before they are 15 years old, many of them defeated by bullying and homework that is hard to finish in cold and unlit homes. Only one in a thousand is educated beyond the secondary stage. The statistics are grimmest in former communist countries, where most Gypsies live. For instance, of the 20,000-odd Gypsy children of secondary-education age in Montenegro, only three (yes, three) go to school. But it is not much better inside the EU. In Greece, 80% of Gypsies are illiterate.

There are at least 6m Gypsies, or Roma, in Europe, of whom more than two-fifths are children. Keeping them at school is the key to lifting their community out of the third world. Classroom apartheid and the illiteracy it breeds will not end quickly, not least because traditional Gypsy parents reject assimilation.

But there are some hopeful signs. New pre-school programmes in several countries, notably the Czech Republic, Hungary and Slovakia, now help Romany-speaking tots to learn the main language of the country in which they live before starting primary school, so saving them from the special schools and a life of—at best—menial labour. The recruitment of teaching assistants who are themselves Gypsies has done wonders in some schools, as they nurture and cajole the children. Extra money for meals at school has helped malnourished children concentrate on their studies. New curriculums that give the Gypsies' own culture a fair wind have engaged the imaginations of children who might otherwise have dropped out. And for the few who do manage to finish secondary school, new university scholarships are on offer. Still, successful programmes tend to be on a small scale and run by private groups. The trick will be getting governments to adopt them.

Boarding school is one radical idea. NGOs and Gypsy leaders are queasy about separating children from their parents, no matter how abject their home life. But the most successful Gypsy schools are boarding ones, such as the partly state-financed Gandhi College in the Hungarian town of Pecs. Its 200 pupils are from southern Hungary. Some of them do go on to university and in time, the school hopes, will provide the embryo of a Gypsy intelligentsia.

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Romania's reforms

A flicker of hope

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Romania is a bit less gloomy than it was, but joining the EU is still a dream

PA

Nastase may have backbone

IT IS a curious country: Balkan in geography, Orthodox in religion, Latin in language and (many say) in temperament, European in ambition, yet undeniably North African in its level of development. Corruption, incompetence and dithering have cost Romania dear since 1989, when a revolution put a bullet in the head of its communist dictator, Nicolae Ceausescu. It is still, by most measures, the laggard of all the former Warsaw Pact countries, slipping behind even Bulgaria, its battered Balkan rival. So why did France's foreign minister, Hubert Védrine, say last week that it should be let into the EU in the first “big bang” in three or four years' time, when ten countries, most of them in Central Europe, are expected to get in?

Not, alas, because he really thought Romania might do so (see article). In truth, it will be lucky to join the club by the end of this decade. And its bid to join NATO next year, its stated foreign-policy priority (ahead of joining the EU), may well be rejected for a second time at the alliance's Prague summit. Its economy is still only three-quarters as big as it was in 1989. Rural Romanians barely subsist. The average month's wage even in towns is $150.

But at least Romania has a slightly better government than before. Nearly a year into his job, the country's prime minister, Adrian Nastase, a former foreign minister and sometime law professor, is raising hopes. Romanians may at last have found a prime minister with a backbone. At the head of a leftish Social Democratic government, he has edged his country in the right direction. Inflation is down, the economy is set to have grown by a perky 5% in the past year, privatisation has been speeded up, and foreign investors and bureaucrats in Brussels are taking a bit more interest. Since September 11th, says Mr Nastase, Romania has become a “de facto member of NATO”. That, at any rate, is what he told people last month in London and Washington, in the hope that they would reward him for his efforts by opening the doors to the West's clubs and by giving him more cash for reform.

Can Mr Nastase prove himself deserving of such help? Unlike his predecessors, he is at least telling Romanians the truth about the economy. He says he must take harsh measures not just to impress visiting Eurocrats but to prevent Romania from sliding into the third world like its eastern neighbours, Moldova and Ukraine.

In the past few weeks he has been gradually putting up the price of electricity and heating. He has also been standing up to disgruntled trade unionists in loss-making state-owned enterprises. When workers at a state-run lorry factory protested against plans for privatisation, he frankly told them there was no alternative, since they were making lousy trucks that nobody wanted to buy. At the same time, however, he says he wants to put up pensions for 6m impoverished elderly Romanians.

So far, Mr Nastase has ridden his luck. Pollsters say that over 60% of his compatriots think he is doing a good job. For once in tune with their government, most Romanians want lower inflation and the sale of state assets. Those who work in the country's burgeoning and surprisingly resilient private sector think the job losses that tend to go with privatisation mean that the government is getting serious about killing off state behemoths that have long been draining public coffers. Another hopeful sign is that Mr Nastase's comparative popularity has weakened support for the opposition Greater Romania Party and its leader, Vadim Tudor, a sycophant in Ceausescu's court whose xenophobic nationalism won him 33% of the vote in last year's presidential election.

Corruption and inertia, the twin foes of Romania's reformers, could yet undo Mr Nastase. Too much time and energy is still being wasted doling out jobs and favours to government supporters. Successes in privatisation, such as the recent sale of Sidex, a failing steel plant in the grimy Danube delta town of Galati, to an Anglo-Indian company, have been offset by failures. Recent efforts to sell state concerns in chemicals and tobacco have gone wrong, with bidders complaining about murky dealings. The government will have to do better with the forthcoming sale of state banks and energy companies, including Petrom, the state oil company.

Still, Mr Nastase has shown that Romania's creaky machinery of government can be just about made to work, if the political will is there. But—as Mr Védrine knows—the problems in farming, the environment, education and health care, to name but a few, remain daunting.

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France and enlargement

A whiff of veto in the air?

Nov 29th 2001 | BRUSSELS
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France is making its fears of a larger European Union more public

EPA

Védrine eyes the future, queasily

ARE the gloves coming off at last? For years there has been speculation that France is quietly opposed to enlarging the European Union, to take in as many as 13 mainly Central European countries. Now, just as negotiations are entering what should be their final, crucial year, negative noises are indeed coming from the powers-that-be in Paris.

Last month the European Commission put out a report suggesting that ten countries could wrap up negotiations by the end of next year. Hubert Védrine, the French foreign minister, responded by saying that he thought the EU should try to take in all 12 of the countries in negotiation—including Bulgaria and Romania, the two notorious laggards.

Superficially, this sounds generous. But in Brussels it is widely seen as a blatant effort to throw sand in the engine. The Bulgarians and Romanians themselves had already said they would not be ready to complete negotiations by the end of next year. When Mr Védrine suggested that, since some countries in the favoured ten were already being granted special favours on political grounds, the same privileges should be extended to the Bulgarians and Romanians, he seemed to cast doubt on the integrity of the whole enlargement business. The front-runners—the Poles, Czechs and Hungarians—are indignant.

The notion that the French establishment might be pondering a veto was then bolstered by a front-page article last week in *Le Monde* entitled, “Who will dare say no to enlargement?” It suggested that “political correctness” was preventing European leaders from pointing out a “double truth”: that the EU's institutions will be unable to cope with the new members; and that countries seeking to join will be unable to meet the demands of membership. Enlargement, the paper lamented, meant that the EU would slide into being “a wide free-trade area” that would mark “a British victory over the former Franco-German vision” of how Europe should be run. Only France, said *Le Monde*, could break the politically correct consensus on enlargement. One article in an influential newspaper may not precisely reflect official thinking. But EU officials note that French correspondents in Brussels have recently dined with both Mr Védrine and with Pierre Moscovici, France's Europe minister.

Certainly, France has sound nationalist reasons to fear enlargement. Ever since its foundation, the EU has been driven forward by a Franco-German partnership. The French clearly worry that a bigger EU will mean that Germany, at a new geographical hub of the Union, will look east as much as west. That might drop France into the rank of second-tier powers in Europe, alongside Britain, Italy, Spain and Poland. Particular French interests might also be threatened. France does very well out of EU farm aid, but much of that might go east in a bigger EU. Besides, the Central Europeans speak English more than French. And, because of cold-war memories, they may make EU foreign policy more pro-American than the French would like.

If France could block the club's expansion, that might then let it push for a tighter Union of 15, still centred on the old Franco-German alliance. The snag is that an overt blocking move would antagonise Germany's elite, which sees enlargement as a strategic and moral imperative.

It may be possible, however, to hold matters up indirectly. The hardest issues—regional funds and farm aid—are still to be negotiated. Irish voters may do France a favour by again rejecting the Nice treaty, widely if incorrectly assumed essential to enlargement. And then there is Cyprus. Many countries within

the EU are anxious about letting a divided island into the Union. But Greece says it will veto all the applicants if Cyprus is kept out. Why not let Greece do France's dirty work?

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France and torture

An awkward case

Nov 29th 2001
From The Economist print edition

Why a retired general's admission about torture in Algeria is embarrassing

EPA

Too frank, mon général

CAN 83-year-old General Paul Aussaresses, one-eyed and hard of hearing, justify the use of torture? Of course he can. “If I had bin Laden in my hands, I would do it without hesitation. In any event, I am sure every army in the world today is still employing torture.” In other words, the end justifies the means, even if the means were as horrible as the various methods—be they beatings, electric shocks or summary executions—practised by Mr Aussaresses as a young officer in France's special forces for two years during the Algerian war of independence.

The argument may well gain more sympathy today than it would have before the terrorist attacks in America on September 11th. After all, the intelligence services of France and other countries are working around the clock to dismantle Osama bin Laden's al-Qaeda network. French and Belgian police arrested another 14 suspects on November 26th.

The question, however, is whether the argument will convince the Paris judges who this week spent three days presiding over the trial of Mr Aussaresses for “condoning war crimes”, a charge that can carry a sentence of five years in prison and a fine of FFr300,000 ($40,000); the prosecutor has asked for a fine of FFr100,000.

The case arises from the publication in May of Mr Aussaresses's memoirs of his service in Algeria in 1955-57. When the book appeared, President Jacques Chirac declared himself “horrified”, and ordered the general to be stripped of his *légion d'honneur*.

So why was the disgraced soldier, along with two publishing executives, brought to trial for admitting his actions rather than for the actions themselves? The legal reasons are that in 1968 the French parliament declared an amnesty for all crimes committed during the Algerian war of 1954-62; that France's statute of limitations for murder is a mere ten years; and that convictions for “crimes against humanity” can apply only to crimes committed during the Nazi period or, under a new and broader definition, after 1994.

Put the legalisms to one side and the fact is that the French establishment has preferred to ignore the horrors of a war that, according to some estimates, cost up to 1m Algerian lives. After all, to have admitted to what had gone on would have cast discredit on too many people, including, according to the general, the late President François Mitterrand, who in 1957 was France's minister of justice. Indeed, only in October 1999 did the French parliament officially recognise the Algerian conflict as a “war”, and only in April of this year did the prime minister, Lionel Jospin, authorise the archives of the period to be opened.

Mr Aussaresses's presence this week in court had nothing to do with the government. The prosecution was initiated by the French affiliate of the International Federation for Human Rights, an independent body, that cannily used the French parliament's acknowledgment of “the Algerian war” to invoke the little-known law against condoning war crimes.

Nor is the human-rights federation alone in its judicial pursuit. Urged on by the general's victims and their relations, a French court will decide later this month whether, despite the amnesty, he can still be tried for crimes against humanity. In which case, will the old man regret his explanation for belatedly bursting into print? “There is a duty of silence, which can sometimes be a cover for cowardice, and there

is also a duty to tell one's story.”

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Charlemagne

In defence of Romano Prodi

Nov 29th 2001
From The Economist print edition

The European Commission's boss is being attacked for the wrong reasons

Get article background

FEW serious historians these days subscribe to the “great man” theory of history, in which events are shaped above all by the titanic efforts of men of destiny. Perhaps it is time also to ditch the “not so great man” theory of history, at least as applied to the European Union, and to Romano Prodi, the European Commission's beleaguered president.

According to this theory, the EU is in big trouble and much of the fault lies with Mr Prodi. In recent weeks, Europe's heavyweight newspapers have piled into him. The *Frankfurter Allgemeine Zeitung* published a long and damaging criticism, calling the poor fellow “maladroit and inept”. Then it was the turn of *Le Monde*, which became the latest paper to float the idea that Mr Prodi's performance is so bad that he may have to resign before his term is up in 2005. “In the conversation of European diplomats,” it reported, “the comparison between Romano Prodi and Jacques Delors comes back like a chant.”

Ah, Jacques Delors. Poor Mr Prodi is haunted by the comparisons with his French predecessor (there was a hapless Luxemburger in between), who is revered in Brussels as the euro's founding father and the most dynamic president the commission has ever had. Just to rub it in, Mr Delors recently issued his own “Wake-Up Call for Europe”. The paper, which was signed by a clutch of prominent Europeans (including two German ex-chancellors, Helmut Schmidt and Helmut Kohl, and several ex-prime ministers, among them Spain's Felipe Gonzalez and Italy's Giuliano Amato), did not mention Mr Prodi by name. But it intoned that “for a number of years the EU has been losing momentum”. Europe is suffering from a “crisis of European identity and increasing disillusionment among Europe's citizens.” Much of the blame for this sorry state of affairs, it made clear, lay with the lack of leadership from the commission. Just to complete Mr Prodi's humiliation, he was obliged to grin for the cameras while accepting a special copy of the report from Mr Delors himself.

A load of Coquilles St Jacques

To be fair, it should be pointed out that Mr Delors's claim that the EU is “losing momentum” is self-serving nonsense. In a few weeks it will launch its most spectacular act of integration: the physical

abolition of 12 currencies and their replacement by euro notes and coins. At the end of next year, it plans to complete negotiations to add no fewer than ten new members to the present club of 15. By 2003 the EU is likely to have a 60,000-strong rapid-reaction force at its disposal, at last giving it some military muscle to back up its foreign-policy ambitions. Efforts to create a common “judicial space” are also advancing, with the foundation of an EU police force (Europol) and a prosecutors' office (Eurojust). And this is stagnation?

Mr Delors's argument depends on dismissing the significance of the EU's enlargement. He bemoans “the lack of any common political project beyond expansion”. But it is hard to think of a more important—or a more politically and technically tricky exercise—than pulling down the last shreds of the iron curtain and bringing former Soviet satellites into the EU. Mr Prodi is surely right, by contrast, to hail enlargement as the great “political project” of his term in office.

This is not to deny Mr Prodi's failings as the commission's boss. He has an academic, rambling and emotional way of talking that makes him delightful to sit next to at a dinner party, particularly if you are slightly drunk, but makes him a poor communicator. He is also bad at the crucial job of building bridges with the leaders of Europe's governments. But it is hard to argue against his strategy for his term of office: to enlarge the EU; to liberalise its countries' economies; and to put it more in tune with its citizens' wishes.

For when Europeans have been asked directly about a step towards European integration, they have often said no. The Danes voted against joining the single currency; the Irish voted to reject the Nice treaty that paves a way to enlargement; the Swiss, who are not members of the EU, voted against even having a formal discussion to join it. The euro is being launched only because most countries pulping their currencies in January chose to avoid the Danes' option of actually asking for their voters' assent. Opinion polls in Germany, the EU's biggest country, consistently show that its voters would have spurned the euro.

All these votes and opinion polls suggest that European voters are far from convinced, to put it mildly, by Mr Delors's pan-European vision of a tighter political union. Yet Mr Delors's cure for what he admits is an “increasing disillusionment” with “Europe” is for the EU to integrate “faster and further”. A severe case of indigestion? Then have another seven-course meal.

Well, shoot the messenger, then

As it happens, Mr Delors's suggestions for a new “political project” are vague. They consist largely of proposing that the president of the commission should be elected; that there should be a “common platform for fiscal and social matters”, “an agreed model of society”, and that the countries that make up the EU should take more decisions by majority vote.

Mr Prodi probably agrees with most of that. Many of these ideas will, in fact, be discussed in a constitutional pow-wow that the EU is convening next year. The Delorsian critique, in essence, is that faster and further integration is unpopular—and that this is Mr Prodi's fault. But that ignores the lousy hand that fate, and Mr Delors, dealt the Italian. He had to take over a commission that had just resigned en masse, after a corruption scandal that flowed fairly directly from the managerial culture bequeathed by Mr Delors. And he was faced with the fact that the “great leap forward” of the Delors era was built on feeble popular support. Mr Prodi may well be a lousy salesman too. But the real problem is the message, not the messenger.

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British Nuclear Fuels

With one bound

Nov 29th 2001
From The Economist print edition

The nuclear programme has cost British taxpayers £42 billion

EVEN for a state-owned company, British Nuclear Fuels Limited (BNFL) always had a decidedly odd set of accounts. It has shareholders' funds of £356m and total liabilities of £35 billion, mostly to do with decommissioning its nuclear reprocessing plants. Technically it is insolvent.

On November 28th, the government tried to make sense of it, by setting up a Liabilities Management Authority to assume the £35 billion of BNFL's liabilities plus a further £7 billion belonging to the UK Atomic Energy Authority (UKAEA). This body will take over BNFL's most troublesome assets—its Sellafield reprocessing plants and its ageing Magnox nuclear power stations. BNFL will continue to operate these facilities, under contract, and look after their decommissioning as it falls due, without having the crushing liabilities of Britain's nuclear legacy on its own balance sheet.

For the moment, the government's move changes nothing for taxpayers, since the government ultimately stood behind BNFL and was committed to covering future decommissioning costs over 100 years. “This just makes things more transparent,” says BNFL's chief executive, Norman Askew, “since the government was already behind the company.” The point of the move is to prepare the company for privatisation: at one bound, BNFL is transformed from a shackled nuclear processing company to a nuclear industry service outfit, which it should be possible to privatise in a few years.

But it leaves BNFL engulfed in controversies, ranging from rows with the Japanese over quality problems with test batches of a mixed oxide (MOX) fuel a couple of years ago, to ongoing legal challenges to BNFL's plans to open a full-scale MOX plant alongside its giant, £2.5 billion THORP reprocessing plant at Sellafield.

BNFL is anxious to start up its so-called MOX plant before Christmas. The government has given the go-ahead. But the Irish government, which is concerned that it will add to the radioactive pollution that has been poured into the Irish Sea, is seeking an injunction from a United Nations tribunal, which governs the law of the sea, to block the start-up. The tribunal is expected to rule on December 3rd.

Irish objections aside, the economics of MOX make no sense. It was dreamt up to improve the economics of THORP, originally conceived in the 1960s to extract plutonium (for bombs and fast-breeder power stations) and uranium (thought to be scarce) for conventional nuclear generators. But the end of the cold war, the abandonment of fast-breeders and a glut of uranium left THORP high and dry. So the wheeze was to convert its output of plutonium into mixed oxide fuels for nuclear reactors. These fuels would be bought back from Sellafield by the countries which sent their spent fuel there originally. That way, Britain would avoid being a nuclear dustbin, while the customer countries would take responsibility for the plutonium they had created.

Now that the Sellafield reprocessing plants are moving back into the public sector, it is time to abandon attempts to make their business look profitable. Two figures shine through the muddle over the finances of MOX. One is that the MOX plant is represented in BNFL's balance sheet as an investment of £473m. The other is that the present value of the income that the project can expect to earn over its life is around £200m. So any so-called profit would come only after writing off more than half the original investment. With this week's announcement, the lucky taxpayer has taken responsibility for financing the gap between the two.

The gap would be larger were it not for BNFL's biggest customer in Britain, British Energy (BE), the privatised company that runs Britain's modern nuclear stations. It is locked into 20-year contracts for reprocessing, at an annual cost of £300m, but would prefer to store spent fuel for only £50m a year. Now

that Sellafield will no longer pretend to be a commercial venture, maybe BE can renegotiate its contracts. That would make MOX look even more pointless than it already does.

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Shakespeare

Brave new world

Nov 29th 2001 | STRATFORD-UPON-AVON
From The Economist print edition

A Third Way for the Royal Shakespeare Company causes a stir

ART and commerce: two houses, alike in dignity, but, according to some, with nothing much in common. Although artists have always relied on moneymen, some still find the idea distasteful. This ancient grudge has resurfaced in a controversy over plans to revamp the Royal Shakespeare Company (RSC).

Adrian Noble, the RSC'S artistic director, wants to demolish the main, unloved theatre in Stratford-upon-Avon and replace it with a £100m ($142m) “theatre village”. Next year, the RSC will forsake the Barbican, its equally unprepossessing London base, to play in the West End and elsewhere. Mr Noble wants the RSC'S brand to work harder abroad, especially in America. The aim is to be more nimble artistically, and to increase audiences and revenue. Cue sound, fury, narrowly averted strikes and high-profile resignations.

The viability of these ideas is questionable, and Mr Noble may be guilty of hubris. But that old dramatic flaw seems to be less offensive than the sin of commercialism. Stratford, Shakespeare's birthplace, is already over-populated by mock-Tudor cottages and shops with names spelled using that peculiar generosity with vowels that is supposed to signify Olde Englande. Nevertheless, hearing Mr Noble talk about “generating other income streams” is enough to have some in the arts world reaching for their rhetorical revolvers.

Two other well-worn arguments inform such reactions. One concerns public subsidy. The RSC will receive £12m this year from the Arts Council. Purists think subsidised arts bodies should produce only work which commercial venues wouldn't. They worry that the RSC will rely too much on men in tights apostrophising skulls, and the sort of celebrity casting which recently had taxis ferrying tourists from Heathrow to see Ralph Fiennes in “Coriolanus”. Mr Noble thinks subsidy involves a responsibility to maximise income, which, he says, can be used to fund artistic risks and build new audiences. He points to a forthcoming adaptation of Salman Rushdie's “Midnight's Children” as evidence of a cutting edge.

The other argument concerns “dumbing down”, and the rivalry of “high” and “low” culture. This encompasses both sterile comparisons of Bob Dylan and John Keats and periodic rows over government funding. Since Labour came to power, the high arts (such as theatre) have continued to feel the pinch, for which many artistic luminaries blame the novelty-obsessed government. The Millennium Dome hasn't helped. So when the principal custodian of the nation's greatest cultural assets talks about public-private partnership, and what sounds a lot like a Third Way for Shakespeare, some grandees worry.

The experiences of Shakespeare's own acting company, which was also a business company, suggest they shouldn't. As Peter Holland, director of the Shakespeare Institute, says, “Shakespeare was the most popular and commercially successful dramatist of his time.” His company had to reconcile the demands of royal patronage (the Renaissance equivalent of subsidy) with those of commercial audiences. Shakespeare dismissed the groundlings as “capable of nothing but inexplicable dumb shows and noise”, but gave them the rude jokes, propaganda and the old tales they wanted. In 1599, the company made a risky move from Shoreditch, to compete for custom with the brothels and bear-baiters of licentious Southwark. It didn't do too badly.

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Fortnum & Mason

Fine teas and poor management

Nov 29th 2001
From The Economist print edition

Traditional Englishness can be taken just a little too far

THERE is only one shop in London where the discerning consumer can buy both Green Assam Khonga and Darjeeling Jungpana (finest second flush) tea: Fortnum & Mason, on Piccadilly. This most superior of shops should have done rather well out of the long boom of the 1990s, but it didn't. Last year, profits were £2.3m ($3.3m), down from £3m five years ago; and investors are grumpy. So, this week, after 62 years on the stockmarket, Fortnum's joined a growing list of companies returning to private hands.

On the face of it, shareholders ought to be relieved. The Weston family, which had owned 89.9% of the company, has now bought the remaining shares—whose value halved between 1995 and 2000—for £6 each. This represents a premium of 69% over the share price when the deal was first announced, and values the company at £57.4m. But many shareholders are disappointed with the price, and even more so with the management of the store.

Ray Tilson, head of Tilman Asset Management, a Dublin-based firm, argues that the £6 offer valued only the existing assets (including the building on a prime London site), but failed to reflect the potential of the Fortnum brand. Under new, rather than more of the old, management, he thinks the company would be worth more like £100m.

The trouble is, Fortnum's brand has been woefully managed. It makes most of its money in the ground floor food hall. The three floors above, selling clothes and knick-knacks, are customer-free zones. The store has always traded on an ersatz version of “traditional” Englishness, unrecognisable to most Englishmen. But in the past five years, according to Iain Ellwood of Cobalt, a branding consultancy, Fortnum's traditionalism has come to look frumpy, and the store to resemble the “ageing aunt of the retail business”. Rita Clifton, chief executive of Interbrand, describes the store as “stuck in a time-warp”.

If the Weston family now carries on regardless (and it shows no sign of changing its ways), the Fortnum brand could become permanently devalued. Ms Clifton points out that other, smarter stores, such as Harvey Nichols, have entered the luxury-food market in recent years as well, so even Fortnum's core business now faces stiffer competition. She describes Fortnum's as a “sleeping luxury giant”. It will have to wake up quickly.

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Business in the regions

Nothing ventured

Nov 29th 2001 | LIVERPOOL AND EDINBURGH
From The Economist print edition

Any entrepreneurs out there?

The government is putting money into venture capital to boost the business birth rate in the regions. Scotland's experience says it won't

FOR all Gordon Brown's love of prudence, the chancellor is mighty fond of the riskiest of all forms of investment—venture capital. His pre-budget report promises a £50m venture-capital fund for small businesses. This comes on top of 12 other such funds totalling about £400m that the government is promoting in the English regions.

It is a common complaint among would-be entrepreneurs that they are frustrated by a shortage of finance. High-street banks need to have security for their loans and like to see evidence of a business track record. Many would-be regional entrepreneurs cannot supply either. As the costs of taking a £100,000 and a £1m equity stake are similar, venture-capital funds do little small-scale funding. So money for business ideas costing less than £500,000 is in short supply.

Since the business birth rate varies markedly across the country (see chart), the government is using venture capital to try to close the gap. Nine regional venture-capital funds are being set up. They will have a total of £200m to invest, including up to £79m of government money. In Britain's four poorest regions—Cornwall, South Yorkshire, Wales and Merseyside—£93m of EU money is going into another four funds totalling £200m. They will offer loans and equity stakes, ranging from £15,000 to £500,000, to new and expanding businesses which have been turned away by private firms.

These funds are modelled on the Merseyside Special Investment Fund (MSIF) which has now invested nearly all the £32m that it started with five years ago. It has brought in another £88m of private money, helped 327 business start-ups, 207 expansions and 19 management buy-outs. By this yardstick, the £450m in the 13 new funds should lure in another £1.2 billion, a massive sum compared with the £700m which the British Venture Capital Association says was privately invested in start-ups and early-stage companies in 2000.

Despite Merseyside's bleak reputation, the MSIF managers say they expect a return of 20-25%, average for the industry. This has helped persuade Barclays, banker to six of England's nine regional development agencies, to put £84m into the four poorest regions' funds. “We would not be getting involved if we did not think it was

commercial," says Joe Docherty, director of the bank's regional unit.

Scotland's experience is less encouraging, however. In 1993, Scottish Enterprise, an economic development agency, embarked on a big exercise to boost Scotland's low business birth rate, including venture capital, teaching enterprise in schools and helping universities to spin out academics' discoveries into new companies. The agency now spends about £14m a year on this strategy. But five years after the programme was launched, Scotland's business start-up rate was 27% lower than the British average—a slightly larger gap than when the scheme began.

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Railtrack

Destination unknown

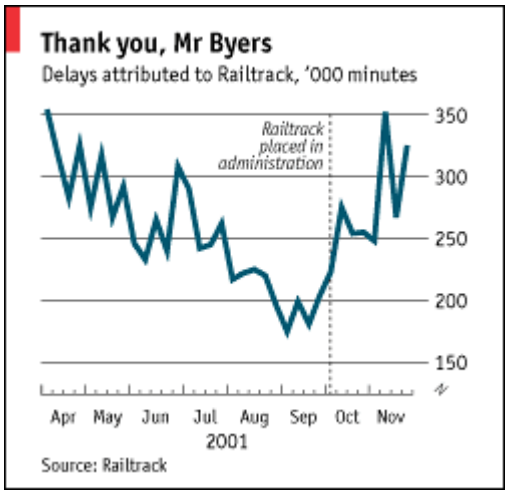
Nov 29th 2001
From The Economist print edition

The costs of Railtrack's crash are adding up

WHEN the transport secretary, Stephen Byers, put Railtrack into administration seven weeks ago, he said it was “a golden opportunity” to create a new railway. As teams of accountants, lawyers and bankers struggle to make sense of the mess left by the bankruptcy of Britain's network operator, things are looking more like a horrible mess.

Mr Byers said that the railways would continue to run normally, thanks to emergency government funding. That turns out not to be the case. Railway performance is deteriorating fast. Since Railtrack went bust, there has been a 46% increase in delays (see chart). One industry observer says this is hardly surprising. “No one knows what is happening.”

Demoralised staff are now leaving Railtrack in droves. In the past few weeks, both the leader of the west coast main-line project and the head of information technology have resigned. There has also been an exodus of middle-ranking managers. Those who deal with Railtrack on a daily basis complain that their calls are not being returned. “Railtrack has simply gone missing,” says a train operator.



Mr Byers initially predicted that administration would last less than six months, after which a non-profit-making trust would take over the operation of the network. He now admits that administration may last as much as a year because “the situation was far worse than we originally expected.”

It remains unclear whether the government will succeed in its plan to create a non-profit-making trust to take over from Railtrack. It has now appointed a chairman, Ian McAllister, chairman of Ford of Britain. But the administrators have the task of assessing competing bids from two investment banks, West LB and Babcock & Brown. A financier involved says that the transport secretary had failed to think through the implications of his actions: “He is like a man with an abscess under his tooth. He just wanted to get rid of the pain.”

The transport secretary's reputation is in trouble in other ways. Railtrack's shareholders are suing the government, claiming that the company was forced into administration for political reasons. Mr Byers denies this, saying that, during a meeting on July 25th, Railtrack's chairman, John Robinson, had demanded more public money to keep the company in business. This week Mr Byers's department released minutes of the disputed meeting. They do little to support his claim.

While the lawyers wrangle, costs are rising. The administrators, Ernst & Young, have raised their estimate of the additional cash needed by the end of March (to keep Railtrack going) from £2.1 billion to £3.5 billion. Industry sources say the figures are likely to get worse. Railtrack had planned to lay off some 10% of its staff—more than 1,000 people—and switch to a new regional structure to bridge its £4 billion gap in funding. These plans have now been postponed.

Ernst & Young's bill for its first 24 days' work was £1.7m. That is only a small part of the rapidly rising bill for the hundreds of professional advisers who are now beavering away in Whitehall. In the past year alone, the transport department has hired 23 different sets of railway consultants and advisers.

A further worry is the risk premium that rail investors may demand because of the Railtrack debacle.

Even before Railtrack's demise, investors were hardly queuing up. Now John Redwood, a former Conservative trade secretary, claims that the additional costs of financing new rail projects will far exceed the £2 billion compensation that Railtrack's shareholders are demanding. Some industry sources are gloomily predicting that new private investment will now simply dry up. An executive at one of the train operating companies says that the projected £34 billion of private investment in the government's 10-year transport plan has “disappeared over the horizon.” Rebuilding the railways is going to take time.

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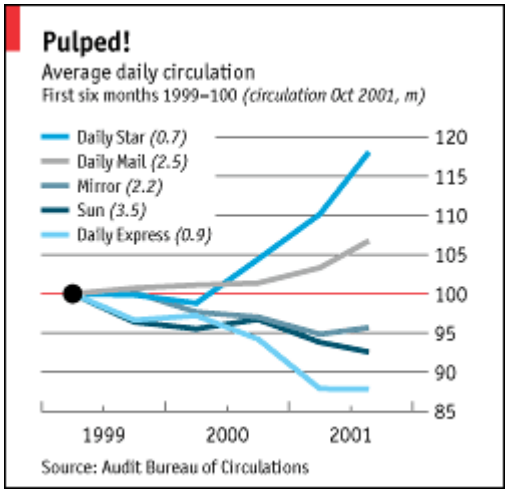
Tabloid newspapers

Star turn

Nov 29th 2001
From The Economist print edition

Newspapers can still make money. But can they make gentlemen?



CALL him a porn baron and he will probably sue. A year after Richard Desmond took over ownership of Express Newspapers, the man whose business interests include an erotic television channel, *OK!* magazine and adult titles such as *Women on Top*, may not have managed to match his acquisition of a 100-year-old British newspaper with that of the respectability he seems to crave. Yet, despite the continuing decline of the *Daily Express* and the advertising downturn, he seems to have found a way of making money.

On the face of it, this is surprising. In the six months to October, the circulation of the *Express* sank by 9% on the same period last year. Its Sunday title fared as badly, also losing 9%. Despite its efforts to steal readers from the *Daily Mail*, the bible of middle England, overall circulation at the *Express* has not grown since 1997.

Mr Desmond's troubles with the *Express* encapsulate broader changes in the newspaper market. Over the past decade, the combined circulation of all daily and Sunday newspapers has dropped by 8%, to 27.6m. In particular, younger people are finding their news, in so far as they seek it, elsewhere—on the television, or the Internet. Ten years ago, 29% of readers of the *Express* were under 35 years old, and 41% of them over 55, according to the National Readership Survey. Today, only 22% of them count as young, while 47% of them are over 55—a similar age profile to that of the *Daily Telegraph*.

So why is Mr Desmond feeling cheerful? The chief reason is not the *Express*, but its stablemate, the *Star*. Its circulation shot up by 15% in the six months to October from the same period in 2000. This time, demographics are on his side: over half its readers are under 35, more even than the *Sun*. The *Star* has thrived on a formula familiar to Mr Desmond: stories about soap and pop stars, a gossip column called “Bitches”, and front-page photographs of semi-clad women with such headlines as “Jordan sizzles in sexy frillies”.

Moreover, Mr Desmond has concentrated on uncompromising cost-cutting. In the past year, he has sacked 400 people in the group, or over a third of the entire payroll, creating much acrimony. Among the casualties was Rosie Boycott, the editor of the *Express*, who had been installed precisely to chase the younger female reader, but clashed with her new boss. Several journalists have also left in dismay.

Mr Desmond intends to trim costs further by sharing across his titles such flexible resources as journalists and the expensive rights to celebrity photographs: *OK!* paid £1m for exclusive pictures of the wedding of Victoria Adams (Posh Spice) and David Beckham (a footballer). Thanks in part to this cost squeeze, says Stan Myerson, the joint managing director, the Express group will make a profit of £45m-50m this year, up on the previous year. While not doing as well as the *Star*, says Mr Myerson, even the *Express* is now making money.

Which is one reason why, despite speculation to the contrary, Mr Desmond wants to hang on to *Express*. If the *Star* and *OK!* are more his natural habitat, it is through the *Express* that Mr Desmond, who left school at 14 and made his own money, wants to counter what he regards as the crushing snobbery of the industry. (On his acquisition of the paper last year, the *Guardian* ran an editorial asking: “Is he really a proper owner of the *Express*?”)

Mr Desmond talks about wanting to restore the title to its “former glory”. By backing Labour at this year's general election, he has won political friends. He has been to tea at Number 10. He is sniffing around for other national papers to buy. And he has put up his “adult” titles for sale (though he has not yet found a buyer).

But he is not likely to dissociate himself from soft porn entirely. The Fantasy Channel, Mr Desmond's erotic TV operation, is a handsome earner and he wants to keep it. The quest for respectability ends at the bottom line.

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Bagehot

Something of the night

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Is Michael Howard, of all people, renouncing Thatcherism?

HAVING lost two general elections, two leaders and hundreds of MPs since 1997, the Conservative Party does not have many famous names left on its front bench. Michael Howard is an exception. Indeed, the man recently restored to frontline politics as shadow chancellor of the exchequer may be a mite too well known to British voters. He made so many enemies as John Major's draconian home secretary that it takes only a minute on the Web to find a site urging browsers to wipe the complacent smile from his face by administering a sharp if virtual punch. When Ann Widdecombe, his former deputy, said he had "something of the night" about him, the strange smear stuck, poisoning his 1997 bid to become party leader.

Still, never say die in politics. Mr Howard had a fine time this week using his barrister's skills to poke fun at Gordon Brown, the real chancellor. Responding to the financial plans in the government's pre-budget report, Mr Howard even dared to quip that some of the remarks Tony Blair had made lately about the difficult Mr Brown had "something of goodnight" about them. In the Commons, and later in TV studios, Mr Howard was confident, sprightly and full of fight—rare attributes among today's deflated Conservatives. By the end of the week, Iain Duncan Smith, the latest Tory leader, may well have been congratulating himself for his controversial decision to bring back this controversial old Thatcherite. All the same—sorry to spoil the party—might this also have been the week when Thatcherism died?

Note what Mr Howard did not quite say this week. He taunted Mr Brown for failing to deliver better schools or hospitals. He accused Mr Brown of smothering firms in red tape. He did not, though, attack Mr Brown's chief political message. Here comes a New Labour chancellor daring to tell the Old Labour story that if Britain wants a better health service it will jolly well have to pay higher taxes for it—and Mr Howard misses the chance to remind voters that Tories are the party of low taxes. It took Kenneth Clarke, a supposed Tory "moderate", to warn Mr Brown from the backbenches against expanding the size of the state while the economy was turning down. But the party's high command, supposed now to be in the hands of the "extreme right", appears for the present to have abandoned its attachment to low taxes. This is a cause, says Mr Howard, over which the improvement of the public services must now take precedence.

Does it matter what Tories say from their wilderness? Yes. Opposition parties help to fix the terms of trade in politics. Even after Mr Blair gained power in 1997, Conservatives told themselves that he won only by stealing their ideas. Margaret Thatcher had pulled the whole blanket of British politics right, showing Mr Blair and Mr Brown as she did so that no party could afford to tax and spend in the Old Labour style. Although Mr Blair did raise taxes in his first term, these were at least "stealth" taxes, about which he was suitably embarrassed. In June's general election, the conventional wisdom of both main parties, though not of the Liberal Democrats, was that you win fewer votes by telling voters that you will tax them more.

The fact that Mr Brown is now telling voters just this could be put down to necessity. He has promised to spend the money; this must come from extra borrowing or taxation; the time to say so is just after re-election, when the next election is years away. But there is another possibility. Perhaps he and Mr Blair have changed their minds about what voters will put up with. If so, and if the Tories have changed their minds as well, this would once again change the character of British politics.

Just catching up?

The Tories are generally believed to have won the 1992 election by focusing their campaign on Labour's

“tax bombshell”. But psephologists argue that Labour would have won in 1997 even without promising not to raise income taxes, and early studies of June's election point the same way. One such, by Pippa Norris of Harvard University, points out that the Liberal Democrats did well in spite of their tax promises. She argues that the other main parties failed to log a broad swing in sentiment. Back in 1979 a sizeable chunk of the British electorate was willing to spend less on public services in order to enjoy tax cuts. By last June, according to one poll, only 4% of the electorate, and only 6% of Conservative voters, said they favoured this, whereas 56% favoured increasing both taxes and spending. On this analysis, what happened this week was simply a case of Labour's over-cautious leaders catching up, late in the day, with the fact that the blanket can be safely tugged left again.

Maybe so. But when Labour tugs, why won't Mr Howard tug back? He claims to be a tax-cutter by instinct. But his assertion that rescuing the public services is now a higher priority suggests that the Conservatives, too, have changed their minds. They have not been persuaded that high taxes are good for Britain. But they appear to have been persuaded that calling too noisily for lower ones is bad for the Conservatives, because such noises make voters wonder whether the public services, especially the National Health Service, would be safe under a Tory government. Peter Lilley, a former deputy leader of the party, said exactly this in 1999, only to be sacked from the shadow cabinet by his then leader, William Hague, for having thus renounced Thatcherism. Mr Hague went on to fight June's election on a muddled promise to cut taxes while matching Labour's spending plans on health, education and transport.

Mr Duncan Smith has not yet solved this muddle. What if this really was the week when Labour reverted to its high-taxing ways? The Tories' new leader appears to have advised Mr Howard to pipe down on tax cuts until yet another fundamental review of Conservative policies produces a plan for fundamental reform of the public services. Perhaps this makes some tactical sense. But in the meantime, Mr Brown goes unanswered.

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Work in progress

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The arrival on January 1st of euro notes and coins will be a big step in Europe's history. But the region's single market for business will remain far from complete, writes Andrew Freeman

A FEW enthusiasts will doubtless interrupt their celebrations this new year with a tipsy trip to the bank. From midnight on December 31st, cash dispensers in the 12 European Union countries that make up the euro zone will spit out only crisp new euro banknotes. The new currency will begin to circulate straight away, replacing national currencies such as the French franc and the German D-mark. Within days the euro will have largely displaced national notes and coins. And after a few weeks, as existing currencies progressively cease to be legal tender, the euro will become a true single currency, spanning once unbreachable national borders, whether in the form of electronic payments or hard cash.

It is tempting, but wrong, to see the arrival of euro notes and coins as marking the end of the long march towards economic and financial integration in Europe. More accurately, it should be considered an important new phase of Europe's long-term integration that started with the 1986 Single European Act and the 1992 single-market project. This survey will suggest that the euro is merely another important element in that broader project. For businesses and consumers alike, much remains to be done before the single market will be anywhere near complete. Indeed, in future the euro will play an important part in exposing the local barriers that continue to frustrate the goals of the Treaty of Rome for the free movement of goods, services, capital and people.

That is not to deny the historic importance of the euro's arrival, nor to play down the benefits it will bring for businesses of all kinds. It is by any measure an astonishing achievement, bearing in mind the deep political and economic potholes on the road to monetary union. Europeans may well find it bothersome to adjust to the new currency in the coming weeks, but once it is established, life will become easier. And there is no doubt that once notes and coins are in circulation, the euro will start to influence consumer sectors that have so far remained largely unaffected by single-market pressures.

Once notes and coins are in circulation, the euro will influence consumer sectors that have so far been unaffected by single-market pressures

For many European companies, the euro has been a reality since it became the virtual currency of Europe's unified monetary system almost three years ago. Leading companies such as Siemens, Fiat and Air France have adopted the euro with gusto, revamping their management and accounting systems, bullying smaller suppliers into accepting euro-denominated purchase orders and persuading customers to pay euro-denominated invoices. Since 1999, such companies have profoundly altered their financing strategies, borrowing in euro-denominated bond and money markets and using increasingly sophisticated techniques to lower their overall financial costs.

They have also taken advantage of the greater financial transparency offered by euro-based accounting

to hone their investment policies. A Dutch group considering an investment in Italy, for example, now finds it much easier to evaluate its prospects there than it did a few years ago, and also enjoys a much more stable macroeconomic environment. Similarly, having a single currency has allowed companies to conduct far more accurate internal benchmarking studies to help identify under-performing units and to concentrate their efforts on the areas providing the best returns.

Been there, done that

Many of these companies say the euro challenge is largely over. “It's almost behind us,” says Gerard Kleisterlee, chief executive of Philips, Europe's largest electronics group. “The introduction of notes and coins is not a big step for us.” But they may be making too light of the work still ahead of them. Complex and costly reorganisations involving thousands of staff are continuing. For example, most big companies are waiting until close to the deadline of January 1st to switch their payrolls to the new currency, yet this task requires extensive staff training as well as changes in IT systems.

Eureka 1

	Euro conversion rates	End of legal tender for national currency, 2002	Circulation on Jan 1st 2002 of: euro banknotes volume, bn	euro banknotes value, €bn	euro coins volume, bn	GDP 2000 €bn
Austria	13.7603	Feb 28th	0.55	30.7	1.50	206
Belgium	40.3399	Feb 28th	0.53	24.0	1.96	246
Finland	5.94573	Feb 28th	0.23	8.0	1.07	132
France	6.55957	Feb 17th	2.24	84.2	8.15	1,400
Germany	1.95583	Jan 1st	4.34	254.2	17.00	2,027
Greece	340.75	Feb 28th	0.60	13.4	1.33	121
Ireland	0.787564	Feb 9th	0.22	6.8	1.08	102
Italy	1,936.27	Feb 28th	2.38	97.4	7.24	1,162
Luxembourg	40.3399	Feb 28th	0.05	5.6	0.12	21
Netherlands	2.20371	Jan 28th	0.66	29.7	2.80	395
Portugal	200.482	Feb 28th	0.54	10.6	1.30	114
Spain	166.386	Feb 28th	1.92	68.6	7.09	605

Sources: ECB; OECD

How much this has cost European business is not easy to work out, but in general it seems to have been less than feared. Many companies have taken the opportunity to upgrade their IT systems, making it difficult to identify the costs directly attributable to the euro. Philippe Chapand, finance director and euro project director for Renault's industrial-vehicles arm, calculates his euro-related IT costs at *euro*15.8m, equivalent to 0.3% of annual turnover. He checked with an array of big French companies and, where direct comparisons could be made, found that their costs ranged from 0.3% to 0.5% of turnover.

Complexities abound. One big car maker realised only recently that it risked a blue-collar revolt if it introduced euro pay packets at the same time as simplified payslips. The new payslips have now been postponed until workers are reassured that they are not being short-changed. A large French company discovered that its multiple subsidiaries caused unexpected difficulties because every link in its corporate structure had to be made euro-compatible. For example, one of its French arms had a subsidiary in India, which in turn had its own subsidiary back in France. It was not easy to explain in India why additional IT costs should be incurred for something that was happening so far away.

The impact of the euro is not confined to big companies, however. For their smaller counterparts, and for companies in sectors such as banking and retailing, notes and coins present novel challenges. Retailers, for example, will bear a large part of the costs associated with bringing physical euros into circulation. That has created a big logistical headache, as well as highlighting retailing's pivotal role in the economy. Banks, too, face a difficult transition, especially those with large numbers of retail accounts.

Perhaps most exposed to the introduction of the physical currency are Europe's small and medium-sized companies, which play a particularly prominent part in Germany and Italy. Surveys have consistently shown that the smaller the company, the less likely it is to be ready for the euro on January 1st. Patrick Bertrand, general manager of CEGID, a French software company that has 50,000 small-business clients in France, reckons that by mid-October up to 35% of them were not yet ready for the euro, partly because they were still struggling with the red tape associated with the

introduction of the 35-hour week. Bertrand de Maigret, secretary-general of the Association for the Monetary Union of Europe, a lobbying group, says that about one-fifth of small French businesses are unprepared, and underestimate the problems they could face. Small companies in Italy, Greece and Portugal, he says, are also lagging in their preparations.

The problem is worst at the level of small shopkeepers. A straw poll among the butchers and bakers of Paris in late October found that although more shops are displaying dual prices as January 1st approaches, a worrying proportion plan to take their chances with the new currency, ignoring the euro for as long as possible. Such euro-unready businesses will technically be trading illegally, which could cause nasty knock-on effects in the banking and financial system as payments get held up. More prosaically, customers will find themselves queuing for much longer than normal to buy their *gigot d'agneau* or *pain de campagne*.

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The war of the tills

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Retailers are the front-line troops of the euro conversion

ECONOMIC history offers no precedent for the conversion of the individual European currencies to the euro, nor for the dual-currency system that will briefly operate after the switch. Some 14.3 billion euro notes and 50.6 billion euro coins will have to be put into circulation, and a roughly equivalent amount of existing currency will have to be withdrawn soon thereafter. The logistics are horrendous.

If Germany's stock of 4.3 billion euro notes were stacked up in a single pile, it would be 50 times higher than Mount Everest. The weight of all new euro coins is a staggering 239,000 tonnes, equivalent to 24 Eiffel towers. To distribute the cash in a single day would require a fleet of 478,000 vans. Bad weather around the new year could cause chaos. It may help that different countries plan to distribute cash at different rates. Portugal expects only 8% of its cash dispensers to be stocked with euros on January 1st, whereas France is aiming for at least 55%, and Belgium, Germany, Luxembourg and Austria are planning for complete coverage.

All the euro-zone countries share the date for introducing the new currency, January 1st, but the old currencies will be withdrawn at different rates, reflecting the hands-off approach adopted by the European Central Bank (ECB). In Germany, only the euro will be legal tender right from the start, but retailers and banks will accept D-marks until the end of February. In the Netherlands, the two currencies will coexist for 28 days before the guilder ceases to be legal tender. In France the dual-currency period runs until February 17th, and in Finland, Spain and Italy until February 28th. Geography will also play a part in how quickly the new currency will come into full circulation. Finland, for example, with many relatively isolated towns and villages, will take longer to get the new currency into tills and cash machines than more urbanised countries.

If Germany's stock of 4.3 billion euro notes were stacked up in a single pile, it would be 50 times higher than Mount Everest

Then there is the problem of old currency. Germany is reckoned to have 100,000 tonnes of old D-mark and pfennig coins sitting idle, which must be disposed of as part of the changeover. For months, officials at the Bundesbank have been trying to persuade German citizens to get rid of old coins in advance of the euro's arrival. It is not clear that they have succeeded. National treasuries could receive a windfall gain: experts think that 1% of currency may not be returned and will eventually cease to be legal tender.

Old notes are also difficult to handle. In France the FFr500 note is the favourite for stuffing under the mattress, out of sight of the taxman. Germans are similarly attached to the DM1,000 note. Neither note circulates much. But central bankers are ready for a flood of hoarded large notes surfacing in the final weeks of this year. Many retailers are stocking up, hoping for a spending spree in the run-up to Christmas. Guiseppe Fabretti, vice-chairman of the Co-op, Italy's largest retailing group, thinks that many consumers will buy ahead, both to use up cash holdings and to hedge against the danger of higher prices after January 1st. “We are expecting to lose a percentage of our sales in January while consumers get used to new prices, but some of what we lose then we will have gained in December,” he says.

Central bankers are ready for a flood of hoarded large notes surfacing in the final weeks of this year

The overall effect of the euro will be to simplify Europe's money. The present total of 70 different coins circulating in the euro zone will fall to only eight euro coins, with the slight complication that each country is producing its own designs for the reverse face. The impact on consumers in each country will

be subtly different. France currently has nine coins but Belgium only five, so whereas Frenchmen will notice little change, Belgians will be carrying heavier purses. Retailers in both countries will have to replace their tills.

Most people might think that the biggest impact of a currency changeover would be on banks, and indeed banks will lose a valuable source of revenue, namely the charges they currently levy for changing one currency into another. They will also incur some costs for extra security and staff training. Davide Croff, boss of BNL in Italy, reckons his bank has run up direct costs of *euro*40m in preparing for the new currency, roughly half of which has been for IT systems. Overall, however, banks will not be big losers from the euro.

The devil's in the detail

By contrast, retailers and companies that deal direct with consumers face heavy extra costs. ENI, Italy's biggest oil and gas group, has 9,000 petrol stations, each of which has to have every pump and till converted so that it can be switched to the euro on January 1st. According to Vittorio Mincato, ENI's chief executive, the total cost of preparing for the new currency has been *euro*80m. Intensive training of the group's 40,000 euro-zone staff began in October and will continue until Christmas.

For some companies, the extra costs are sufficient to threaten their already marginal profitability, according to Ludo Van der Heyden, a professor of business studies at Insead in France, and Arnd Huchzermeier, a management professor in Germany. In an influential paper written to call attention to retailers' euro dilemma, they suggest that the typical European food retailer has a profit margin of only 1% of sales, compared with a cost of capital of 5-15%, depending on the company's size and the state of financial markets. Introducing the euro will impose four distinct types of cost:

• **Cash logistics costs**. The simultaneous handling of old and new currencies will require more frequent replenishments by security transporters, and some sales may be lost because of queues at tills.

• **Training and information costs**. Staff have to be properly trained, for instance to use double tills during the dual-currency period. If they give the wrong change, customers will get annoyed and may take their business elsewhere.

• **Security costs**. Retail businesses will need extra insurance and protection against robbery.

• **Financial costs**. Retailers will need to hold unusually large amounts of borrowed cash during the changeover, and will lose interest if there is a delay in sending cash balances to the bank.

Reluctant pioneers

Together, these costs will put severe pressure on retailers' profits. Mssrs Van der Heyden and Huchzermeier offer the following example. Suppose a food retailer normally has a daily cash requirement equal to 15% of sales, and that this rises to 50% during the two-month changeover when two currencies must be handled instead of one. Assuming that the shop is restocked with euro cash daily, the retailer will lose about 12.2%, equivalent to 1.5 months, of its annual profit because of the extra cash costs of the changeover. If, more typically, the shop is restocked with euro only every three days, then the losses multiply because of escalating financing charges and forgone interest.

Small wonder that retailers are less than thrilled to be playing such a prominent part in the euro conversion. Like other businesses, they have had to make expensive adaptations to their internal IT systems, but they have also had to make a whole host of other changes. At Galeries Lafayette, a French retailer, a store-by-store audit revealed that several outlets had to have their floors strengthened to withstand the extra weight of cash after January 1st. The Co-op's Mr Fabretti points out that his company has had to convert 25,000 tills, 15,000 weighing scales and countless shopping trolleys, each of which cost *euro*12 to adapt. He estimates the Co-op's total conversion costs at *euro*150m, a big sum for a group with a turnover of *euro*8.6 billion last year.

At Galeries Lafayette several outlets had to have their floors strengthened to withstand the extra weight of cash after January 1st

Users of cash dispensers will unwittingly play an important part in the launch of

the euro. Banks generally stock their cash machines with large-denomination notes. For the euro, these will be 20, 50 and 100 notes. (The 200 and 500 notes are widely expected to disappear quickly into safety deposit boxes and under mattresses.) A customer who withdraws *euro*200 early next year will probably receive two *euro*50 notes and five *euro*20 notes. But what happens to the *euro*10 and *euro*5 notes?

The answer comes as a surprise. In most developed economies, such small-denomination notes, along with the majority of coins, are permanently shuttling between retailers' tills and consumers' pockets. When a consumer proffers a *euro*20 note to pay for an item that costs *euro*4.99, the retailer needs at least two notes in order to give change. In turn, it recycles the large notes to the banking system when it deposits its takings. But it relies on other consumers who pay with small notes and coins to keep it stocked with change.

These inter-relationships will be vital to the launch of the euro. In normal market conditions, large-volume retailers keep the equivalent of 3-5% of their daily cash sales in their tills. During the dual-currency period, however, they are supposed to give change only in euro, which means they will have to hold lots more cash than normal. Italy's Co-op plans on holding eight times its normal levels of cash, and is doubling the number of cashiers. Tesco, a British food retailer with around 80 shops in Ireland, which unlike Britain is a member of the euro zone, plans to hold five times more cash than normal there, and reckons it will need two or three weeks' cash requirements in advance in order to cope once euro trading begins.

In general, countries have been slow to embrace this idea of “front-loading”—that is, distributing euro in advance of the formal launch on January 1st. However, as launch day is approaching, there has been greater recognition that unless plenty of coins and low-denomination notes are front-loaded, disastrous euro-cash shortages might occur. As Mr Van der Heyden puts it, “You don't open a pipeline before you have filled it with what you want to flow.” If the launch goes smoothly and the euro quickly displaces the old currencies, then retailers' cash requirements will soon drop to normal levels. If it goes slowly, however, there might be dangerous spikes in demand for notes in particular, which could undermine confidence in the new currency.

Help might be at hand from the electronic-payment networks. Europe's banks operate a huge network of terminals, every one of which will be upgraded for the euro. Payment systems such as Visa Europe stand ready for a surge in volumes after January 1st. “For the first time, cards will be more familiar to consumers than their physical money,” says Hasan Alendar, head of Visa's euro unit. Visa has relaxed its normal rules to allow some banks to put a euro symbol on the reverse face of their cards to encourage euro-zone consumers to pay electronically.

If logistics and front-loading were the only problems facing retailers, they might see the euro conversion as simply a temporary headache. But many other difficult issues remain to be tackled. The next two articles will explore perhaps the most sensitive aspects of the euro project: first, the technical pricing challenges thrown up by the new currency, and second, the effect of the new currency on the act of price formation itself.

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Swings and roundabouts

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The perils of pricing in euros

THE Vatican's official currency is the euro, which is somewhat ironic because the new currency holds considerable financial risks for the Catholic church in Europe. For example, the typical contribution to the collection plate at a Sunday service in France is FFr10, in the convenient form of a single coin. After January 1st, there will be two convenient coins to choose from. If all worshippers reach for *euro*1, the church's takings will drop by a disastrous 35%. If they all hand out *euro*2, the church's income will increase by a third, which may be too much to hope for. Prayers are now going up that at least every *euro*1 coin will be matched by the *euro*2 sort, so that the net effect will be minimal.

There have already been subtle price changes to reflect the euro's imminent arrival. For instance, in Paris the price of a single espresso coffee for consumption at the bar was FFr6 for years. Over the summer months, the price quietly rose to FFr6.50, a sum that can be conveniently rounded to *euro*1. For the bar owner, the neat euro price will make life easier after January 1st. For the consumer, it means he simply pays more for the same coffee.

These are only some of the unintended consequences of introducing a single currency. When Europe's political leaders signed up for the euro, they probably had no idea that they would set off a fundamental rethink on prices by almost every business in the euro zone, but that is what has happened. Businesses do not want to confuse their customers, let alone create the impression that they are using the euro as an excuse to raise prices, but nor do they want to lose money.

To understand the complications faced by businesses, it helps to look at a few examples from around Europe. Consider, first, a French vending-machine company. Converting the millions of vending machines in the euro zone to the new currency is a massive task. Coin-operated machines are used for all kinds of things from parking to cigarettes to condoms. This particular case study, provided by IBM Europe, concerns a machine that dispenses coffee in offices, at the price of FFr2 per cup. Converted to euro, the price would be *euro*0.3049. What should the company do? If it were to round the price down to 30 cents, it would lose 1.5% of its revenue per cup, unless it expensively reconfigured the machine to dribble out slightly less coffee. But the price cut would be too small to boost sales to offset the loss.

If it were to round the price up to 31 cents, it would be going against industry recommendations that prices should be in multiples of 5 cents to keep down the cost of handling the smallest coins. It would also find it difficult and expensive to keep the machine stocked with sufficient change. Each customer who paid with a 50-cent coin would need four coins back in change; those who paid with a *euro*2 coin would need as many as eight coins back. If the company were to raise the price to 35 cents, some potential buyers might be put off by the price increase, and it would still have to keep a lot of coins for change. It cannot win. IBM Europe points out that contracts between vending-machine operators and their users will typically have to be renegotiated to spread the pain.

Another example is Deutsche Telekom, Germany's biggest telecoms group, which evaluated 22,000 different tariffs to try to keep telephone charges stable for consumers while minimising rounding problems. It found that one-third of its present charges are not compatible with the euro. A unit price per minute of DM0.1034 converts to *euro*0.0529, but that converts back to DM0.1035. If the unit price is changed to DM0.1033, the conversion works in both directions. This time, the company chose to accept the lower but more efficient price.

Spanish companies, for their part, face a challenge known as the “disappearing peseta”. This arises in

businesses using lots of small components that need to be priced separately in order to assign costs fairly to their suppliers. For instance, a cleaning-products company might use a colourant that accounts for a tiny proportion of a total product, costing perhaps as little as 0.001 of a peseta. Or an ironmonger might stock washers that cost 1.37 pesetas each. These amounts are so small that they generate almost meaningless prices when converted into euro and then rounded to two decimal places.

Here is how the peseta disappears. An item that costs 0.84 pesetas converts to *euro*0.005048, an amount that rounds up to *euro*0.01. But an item that costs 0.83 pesetas converts to *euro*0.004988. Rounded, this becomes zero.

Beware round figures

This is not a theoretical nicety, but a real issue for businesses. The ironmonger's washers, for example, convert to *euro*0.00820359 each. If they are sold by the thousand, that makes *euro*8.20. But the individual price must be rounded to *euro*0.01, which pushes the price per thousand up to *euro*10, almost 22% higher. To avoid such distortions, the company's systems must be set to do rounding calculations only at the end of its accounting processes and not at the intermediate stages.

Companies all over Europe have been wrestling with such problems. Many of the calculations affect internal operations as well as relationships with suppliers. Equally, however, retail businesses face tricky choices when setting euro prices for their customers. In the past, they have relied on sophisticated price “architectures” that combine customer appeal with processing efficiency. In particular, they have made widespread use of so-called psychological price points—amounts such as 9.99 guilders or DM19.90 that require a single coin in change for customers who pay with the nearest bank note.

But once converted into euros, these price points no longer work. The price of 9.99 guilders becomes *euro*4.53, which, converted back again, becomes 9.98 guilders. Most consumers would find that thoroughly confusing. From a retailer's perspective, *euro*4.53 is an unattractive price because it requires at least four coins in change, and possibly notes as well. A price of *euro*4.49 makes more sense, but produces less revenue.

This is a hugely important issue for food retailers. They stock thousands of items and use complex pricing tools to balance prices of their own-label brands with those of the branded goods they buy from manufacturers. Now retailers must apply these pricing tools to a completely different environment.

In September the European Commission revealed a disturbing statistic: two-thirds of European citizens are afraid that they will be cheated by retailers when the euro arrives. Concern over rising prices has prompted a variety of responses. In France, Laurent Fabius, the finance minister, announced in September that a task force of 200 officials would be making fortnightly checks on prices all over the country and that the government would crack down on companies using the euro as a “false excuse” to raise prices. Large French retailers agreed to keep prices stable from November 1st until the end of March next year. Small retailers and businesses have made no such promises. The price of bread and haircuts has gone up.

In Italy, Indicod, a joint association of consumer-goods manufacturers and distributors, agreed not to change prices from November 1st until the end of February, but manufacturers pointed out that this would leave them exposed to any increases in raw commodity prices, and many of them rushed to raise their prices before an agreed deadline of August 1st. A few retailers have given their own price promises. Italy's Co-op, for example, is keeping all its own-label prices stable until the end of March.

Across the euro zone as a whole, most experts agree that for every price rise there will be a price fall, so the net effect of the euro's introduction should be broadly neutral. Recent research by Société Générale, a French bank, suggests that higher prices so far have been limited mainly to the food and clothing sectors, which account for only around 20% of the consumer-price index. The best hope is that the greater transparency offered by the single currency will exert downward pressure on prices everywhere.

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The common good

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The euro is about to expose huge price differentials within Europe

ON THE front page of the European edition of the *Guardian*, a British newspaper, there is a small table showing the price of the newspaper in over 30 countries, from Albania ($2) to Ukraine ($3.50). You might have thought that the imminent arrival of the single currency would have prompted harmonisation of the price within the euro zone, so it comes as a surprise that readers in Greece and Portugal pay *euro*1.67, in France *euro*2.13 and in Finland and the Netherlands as much as *euro*2.61. Before euro prices, such price differentials were hard to spot. Now they are glaring.

The price information on the front of your issue of *The Economist* tells a different story, with prices bunched closely around *euro*4.30. From January 1st, the newsstand price throughout the euro zone will be *euro*4.35. In some markets that means a small price cut, in others a tiny increase. The only euro-zone country where the price will remain out of line is Greece, which joined the euro later than the other members and has relatively low prices for newspapers and magazines.

The Economist's commercial managers decided as long as three years ago to equalise European prices as far as possible, believing that it was better to send a consistent price signal to customers than to price by market. Since then, the price has been capped in the more expensive markets and steadily increased in the cheaper ones to achieve the necessary convergence. The eventual common newsstand price of *euro*4.35 was not aligned to the lowest euro-zone price, because that would have been too costly, but nor was it set to match the highest one, because that would have risked losing sales in cheaper markets. Like businesses all over Europe, *The Economist* had to make a fine judgment based on its knowledge of its customers and markets.

Such judgments are necessary because the greater transparency the single currency brings to prices will make a big difference to the way business is conducted. Simple economic theory suggests that savvy consumers will look across European markets and note where the price of a good or service is lowest. They will then either purchase the good or service there, conducting a form of what economists call “arbitrage”; or they will use the information to prevail upon their more expensive local provider to bring the price down. The overall effect across dozens of sectors will be deeply deflationary. In the face of relentless downward pressure on prices, businesses will struggle to maintain their profitability.

This deflationary pressure will be applied not only by consumers but also by businesses to their own suppliers, thus reinforcing the trend. Big retailers will increasingly seek to buy from manufacturers at a single euro price, whereas now they typically buy locally in each country where they trade. In the past, manufacturers have been able to maintain price differentials because their customers found it difficult to compare prices. With the euro, it will become much easier.

Spot the gaps

All of this is a larger version of the price transparency that the Internet has encouraged in recent years. For consumers and businesses alike, it has become easier to compare many prices and to make purchases online. But the potential impact of the euro across Europe is big enough to make the Internet effect look insignificant. Depending on which boardroom you enter, jokes one management consultant, you can smell either fear or opportunity.

Examples of big price differentials abound. *L'Expansion*, a French magazine, conducted a survey of the euro zone earlier this year and found that a 10-kilometre taxi ride in Lisbon was a quarter of the price of a similar journey in Luxembourg. A kilo of beef cost *euro*15 in Paris, *euro*21 in Amsterdam and *euro*9.90 in Madrid. A visit to the cinema in Dublin or Brussels cost *euro*8, but in Athens you paid only *euro*5.90 to see the same film. A 5-kilo jumbo pack of washing powder cost *euro*9.80 in Brussels, but an extortionate *euro*24.30 in Helsinki. And a packet of proprietary aspirin cost *euro*3.70 in Athens, but *euro*12.90 in Rome and Berlin.

How can such differences be justified? Some companies continue to cling to traditional explanations involving different local tax rates, varying transport costs and so on. The truth is that until now manufacturers and retailers alike have deliberately (and mostly, though not always, legally) exploited the fact that consumers found it hard to make price comparisons. They have also used sophisticated ways of disguising their true prices from each other.

Take the highly competitive consumer-electronics market. Retailers in this sector typically work on a gross margin of 35%, but the true wholesale price they pay to the manufacturer is rarely the amount that appears on the invoice. In addition, manufacturers use a variety of incentives to promote their products, which make it almost impossible for competitors to discover their rivals' true prices. For instance, several big manufacturers have a scheme that gives retailers an annual rebate based on overall sales. Such schemes can be tweaked to encourage the retailers to concentrate their efforts on particular products. The manufacturer might also subsidise credit terms for retailers who want to offer buy-now-pay-later deals.

A.T. Kearney, a firm of management consultants, conducted a study of the relationships between buyers and suppliers in Europe's main consumer-goods sectors and found startling variations in the way goods are bought and sold. It identified no fewer than 216 different structures for what in theory should be fairly similar terms and conditions in contracts. The euro will not entirely do away with this complexity. Indeed, in future some companies might be even more attracted to complicated contracts to keep their competitors in the dark. But the euro will make it harder to maintain such obscurity.

That is why many enlightened firms concluded several years ago that once the single currency had arrived, big price differentials within the euro zone could no longer be justified. They put in hand long-term changes to their pricing policies which have now resulted in single pan-European prices, or at least far narrower price differentials than in the past. A few companies have gone even further and are beginning to try to match product lines with market conditions that vary subtly from country to country.

Ducking the issue

A good example is Mandarina Duck, a successful family-owned Italian company based in Bologna that makes fashionable handbags and accessories. As it happens, when the company started off in business 15 years ago it charged the same prices for its products wherever they were sold. It gradually began to vary them when it found, for example, that it could charge more in Germany than in its home market. Its differentials were never huge, and were intended to reflect consumers' different purchasing power, with German prices perhaps 15% higher than those in Italy and Spanish prices 15% lower. All the same, three years ago the company decided that the introduction of the euro was an opportunity to bring prices much more closely into line. In future only the most attentive consumers will spot any differences between Mandarina Duck's prices, wherever they may be shopping.

The company knew that it could not radically change the retailing culture in different countries, and that it would have to work within existing conventions. For instance, it found that German retailers of fashion accessories work on mark-ups of roughly 2.5 times the wholesale price, whereas Italian ones apply a multiple of 2.15 and their French counterparts of 2.29. “Philosophically, we would like to have a single price,” says Marco Bizzarri, the chief executive, “but failing that, what we can do is to tailor our collections to suit particular markets.” Already, fancier and more expensive products, such as the latest collections of clothing, are sold in the wealthier north of Italy, whereas cheaper ranges are offered in the south.

Prompted by the euro, two other companies based in Bologna have adopted new pricing strategies. Carpigiani is one of the world's leading makers of professional ice-cream machines. Once it knew the euro was coming, it began to adjust its prices, moving away from the highest and lowest levels and getting them to converge towards the middle. “We achieved this without losing margin,” says Gino Cocchi, the group's chief executive, “although it was tough to drive through price increases in the

cheaper markets.” Some small variations remain, but these relate to different warranties and servicing levels rather than to the machines themselves. One thing that helped the company to maintain profits during the price migration, says Mr Cocchi, was the introduction of improved products for which customers were prepared to pay more.

Ducati, which makes expensive sports motorcycles for knowledgeable enthusiasts, earns more than half its revenues in the euro zone. Two years ago it harmonised its after-tax prices throughout continental Europe (but not in Britain), believing that its customers wanted consistency. The company has also been a successful pioneer in selling online, where prices are fully transparent. Its price revamp coincided with a big overhaul of the company's dealer network to ensure that the price regime would be followed faithfully.

Examples such as these can be found among manufacturers and retailers all over Europe. Less obviously, but importantly, there is evidence of a similar trend in some service industries. Alain de Pouzilhac, chairman and chief executive of Havas Advertising, says that his industry is already under strong pressure from customers to accept lower charges: “The transparency brought by the euro will only increase this, although the impact will be felt slowly rather than immediately on day one.”

Havas, the world's fifth-largest advertising group, is restructuring its business so that in future its work will be directed to where it can be done most efficiently. But the company is also creating a portfolio of businesses so that it can offer what Mr Pouzilhac calls “integrated communications services”—in essence, a bundle of marketing and media services that produces higher margins than a single service does on its own.

All too transparent

Even management consultants are beginning to be affected by the new price transparency. One leading European consultant based in Germany says that his firm's clients are becoming more pan-European in their approach to business, and are increasingly asking for standard daily rates regardless of where the work is to be done. He thinks this will soon have a knock-on effect on how the company pays its staff: “Salary differentials will have to shrink if we no longer have differential fee structures.” The company will also have to adapt to a significant drop in the average level of fees in the industry.

One sector likely to feel the effects of price transparency more quickly than most is that of fast-moving consumer goods. Retailers are impatient with what they see as unjustifiable differences between essentially similar products. The wholesale price they pay for goods is an important element of their overall costs, so if they can squeeze lower prices out of manufacturers, their bottom line will benefit. At present, price differentials on manufacturers' leading brands can be more than 30%, so there is plenty of scope for arbitrage by retailers big enough to threaten to buy from someone else.

All the same, industry observers suggest that prices are much more likely to adjust downwards over a period of time than to collapse immediately. And even if retailers manage to squeeze the wholesale prices they pay, it is not clear what they will do with those savings. If they pass them on to consumers in the form of lower prices in the shops, that will put pressure on other retailers to follow suit, which could create a vicious (or virtuous, depending on your point of view) cycle as those retailers in turn will ask their manufacturers for more price cuts.

Well-known manufacturers such as Unilever and Procter & Gamble are only too aware of such risks. Unilever, for example, last year started to simplify its huge portfolio of brands. These days it concentrates on only a few hundred brands rather than over 1,000, as in the past. The stronger and more international it can make its brands, the more easily a company can protect itself against price erosion. Manufacturers such as Henkel, Danone and Nestlé increasingly put the parent brand on all their products. This can be an effective and economical way of improving consumers' awareness.

As these examples show, the euro has forced many big companies to rethink their entire business strategies. As prices converge, it will become increasingly important to ensure that products and brands are positioned in the same sector of the market throughout the euro zone. For instance, one well-known brewer has a brand that is premium-priced in one market, but middle-of-the-road in another. Once the euro is in place, it will have to reposition the brand in the cheaper market so that it does not undermine returns from the more expensive one. Such marketing changes require time and careful planning. For this particular brewer, it may already be too late.

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Borders and barriers

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Does the euro really make the EU a single market for business?

FOR all that it has clearly had profound effects already, and will have even deeper ones after January 1st, the euro by itself can only do so much. It is best seen as one, albeit central, element of a bigger project: to create a true single market in Europe. This view is supported by plenty of academic research on the effects of single currencies on economies and businesses. One useful strand of research led by Andrew Rose, an economist at the University of California at Berkeley, suggests that thanks to the single currency, intra-European trade should fairly quickly double or even treble in volume. If that turns out to be correct, then Europe will greatly surprise the numerous pessimists who have bemoaned its inability to pick up where America's decade of extraordinary economic growth has left off.

However, another important strain of research explains why one-factor changes, such as the introduction of a single currency, have less of an impact than might at first be expected. Subramanian Rangan, an economist at Insead, France's leading business school, has studied globalisation and its effect on large multinational companies' pricing policies and sourcing of goods. He argues that in a large region such as Europe that is moving towards economic integration, it is vital to understand the role played by national borders. “The moment you talk in terms of integration, you presuppose that there are things to integrate,” he says. “But national borders engender discontinuities so profound that they cannot be overcome by removing a single factor among many.”

This argument is important because it explains why the euro cannot be viewed in isolation from other economic forces. Among the discontinuities caused by borders, Mr Rangan includes the following:

• administrative rules and standards;

• social and religious phenomena;

• capabilities, including geography and natural resources;

• economic development and infrastructure; and

• information differences, including language.

The environment in which businesses operate is influenced by all of these. Thus, whereas the single currency will have the important effect of removing the barrier that is currently being imposed by different currencies, by itself it does not change much else. These currencies are simply administrative characteristics defining national economies. Although in future they will no longer exist, nothing else in this particular category of differences will disappear in their wake.

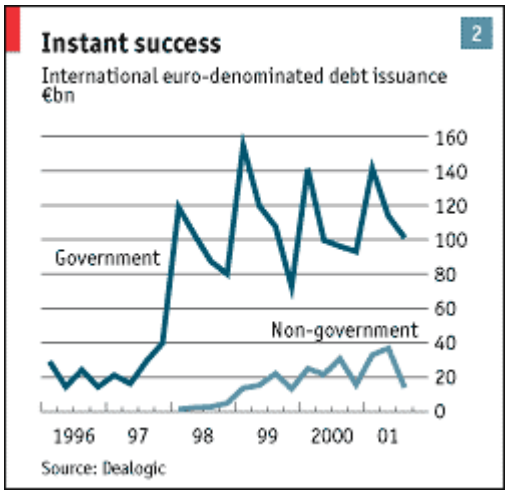
This analysis even puts a different perspective on the euro's impact on price transparency. True, the single currency will make it easier for consumers to compare prices. But the starting point for this change is that Europe currently has heterogeneous customers who largely buy heterogeneous products with different ingredients, labels and packages. Much else will need to converge before prices do.

Indeed, Mr Rangan predicts that although prices in the euro zone will indeed converge, they will do so more slowly than many people think, and mainly in areas where the cost to consumers of making a mistake are relatively low. “No one, if they have a choice, hires the cheapest lawyer,” he says. Mistakes

with big-ticket items, such as cars and houses, are not easy to reverse. Mistakes with health care and drugs can incur irreversible costs.

To see Mr Rangan's point, consider the euro itself. It is Europe's money, but is there as yet a single market in money? A quick look at the banking system or at the broader financial-services industry suggests that this remains a distant goal. The euro has prompted some notable achievements, but there have also been glaring failures, and plenty of gaps remain.

Among the achievements is the euro-denominated capital market. Starting from nothing three years ago, this has become one of the world's main wholesale markets (see chart 2). The euro has removed exchange-rate risk and done away with the segmentation by currency that had previously characterised Europe's money and bond markets.



The interbank unsecured-money market, for instance, is in effect pan-European, with large banks successfully feeding liquidity to smaller, national banks. The secured market has been less successful, largely because its very existence has exposed problems in the underlying infrastructure that can make it difficult to transfer collateral. In time, however, as these problems are tackled, it should become bigger than the unsecured market.

The eurobond market has also been an overall success, thanks in part to the integrated clearing and settlement infrastructure that predated it. In the corporate market, well-known companies such as Philips have launched big benchmark issues, and even a few small, unrated companies such as Ducati have issued bonds successfully. Jan Hommen, chief financial officer at Philips, says the market is becoming deeper and better segmented, pointing to the ease with which he raised *euro*4.25 billion in two separate deals this year.

Observers say that fewer medium-sized companies have raised money by issuing bonds than was hoped at the outset. Until more do so, the bank-driven alternative system of funding will continue to misallocate capital. This is a fair criticism. But the market has shown that it can fulfil its function as a viable long-term alternative to the bank debt that has always dominated European financial intermediation. In the early part of this year it provided a flood of liquidity to telecoms issuers as equity investors' enthusiasm for that industry dried up. The issuance has since also dried up, but it represented progress.

These successes are tempered by the relative failure so far to integrate Europe's equity markets. Although more and more shares are quoted in euros, and there have been some mergers among stock exchanges, the underlying markets remain fragmented. One reason is that equities are more complex instruments than bonds. A more powerful one, however, is that vested interests at local level have blocked efforts to integrate securities markets.

Consider Europe's rival clearing and settlement systems. Ideally, Europe should have a central counterparty for all securities trading, because that would be most efficient for settlement and for minimising movements of collateral. At present, this seems unlikely to happen. In principle, however, it should be possible for several securities markets to co-exist in the euro zone, each with its own trading exchange, clearing mechanism, settlement system and depository.

What time do you open?

For there to be a single market, each individual market would have to allow seamless trading between itself and the other euro-zone markets. At a trivial level, that would require the exchanges and systems to have the same operating hours and to run the same clearing and settlement cycles. At present they are a long way from this, with exchanges opening and closing at different times and relying on a variety of clearing deadlines that require constant vigilance from investors.

Observers say reforms that at first sight appear to be relatively simple have turned out to be a nightmare because individual countries are so reluctant to remove any barrier that might reduce their importance in the overall financial system. The European Commission issued a Financial Services Action plan in 1999 and has since pushed steadily for implementation of its 42 measures by the end of 2005. A report published in February this year by a committee chaired by Alexandre Lamfalussy, a former central

banker, was endorsed at a summit held in Stockholm in March as a sensible basis for further efforts to integrate the capital markets, but for a variety of reasons has made little progress since. And even simple reforms require each country to enact new laws, so there is ample scope for political interference. The bigger the country, the higher the barrier.

More fundamentally, the euro has shone a harsh light on basic differences in the legal concepts that define securities. In America and Britain, the law allows two forms of ownership rights. The first, shared by continental Europe, is full legal ownership. The second, not shared in Europe, is beneficial ownership. This concept allows the creation of depositories in which securities are “dematerialised”. If you buy shares in America, you buy a traceable claim on designated securities, not the securities themselves. By contrast, in Europe you buy the securities direct, and they are held in your name. In America, individual holdings in, say, shares of General Electric can be bundled by money managers into so-called “pooled accounts”, which allows for more efficient administration and trading. In Europe, each account has to be segregated.

When the chips are down

Underlying these legal niceties is a hard-nosed business issue: who owns what, and in which order, in the event of a bankruptcy? In a world of segregated accounts, direct ownership is easy to establish. In the Anglo-Saxon model, however, and in fluid financial markets where collateral is constantly exchanged between counterparties, the issue can be moot. It is particularly moot where the two legal systems overlap, as they do every time a money manager in London trades with one in Frankfurt. Suppose that you pledge shares as collateral for a loan, and later want to reverse the trade. If your counterparty goes bankrupt before your shares have been returned, who owns them? Such problems present serious barriers to an integrated cross-border securities market and will not easily be overcome. And even if Britain joins the euro, these legal issues will still need to be resolved.

The problems of integrating capital markets can all too easily appear unconnected to the daily needs of European businesses. In fact, the lack of a single market in money is a serious blockage in the economy that can have a direct effect on companies. Nothing better symbolises the difficulties of achieving a single market than a recent argument between the European Commission and Parliament on the one hand and Europe's banking industry on the other over the cost of sending a small credit across a national border.

In March the commission conducted a secret study by sending 1,500 cross-border payments of *euro*100 each all over the EU's 15 member states. Seven of the transfers never arrived, of which only five were returned to the sender. But the commission's ire was raised not so much by the lack of efficiency as by the outrageous cost of the transfers. The average charge was *euro*24 and the highest, for a transfer from Greece to Denmark, was nearly *euro*61. Moreover, more than 15% of the payments were unlawfully double-charged, so that both the recipient and the sender had to pay.

At first the issue looks almost academic, because such cross-border payments currently account for only 1% of all payments sent by banks within the euro zone. But on closer examination it becomes clear that this affects businesses as well as individuals. A small business wanting to refund a customer in another euro-zone country might find that the bank charges not only eat up the refund but cost the poor customer money on top. Consumers wanting to buy goods by mail order may be unable to pay by cheque because the seller will be unwilling to accept a payment that carries a levy of nearly 25%.

If a regulation now before the European Parliament is passed in the coming months, it will stop banks from discriminating against cross-border payments, making them charge the same for these as for local ones. At a recent conference, Romano Prodi, the president of the commission, asked: “What use is a single currency if citizens and companies can use it only on paper or in electronic form in their home country?” Frits Bolkestein, Europe's internal-market commissioner, berated banks for a decade of inaction and blamed them for bringing the regulation on themselves. He also warned them against equalising charges upwards by raising the price of local transfers.

The European Parliament is strongly in favour of regulating, but is under pressure to give banks a chance

to compromise. One possibility is that the proposed deadline for regulation to begin, January 2003, will be extended to give banks more time to solve the problem. The European Central Bank is in favour of such an extension. But it does not want cheques to be included in the regulation, arguing that these are an inefficient payment mechanism that should be discouraged even at local, let alone cross-border, level.

Europe's governments, including those that for the moment remain outside the euro, must choose whether they really want to pursue a single financial market. If they do, they will have to generate considerable political will across a number of areas, particularly retail financial services, which currently suffers from a serious lack of pan-European spirit. Otherwise the euro will deliver only a small fraction of its potential economic benefits. But it is not just financial markets that have so far failed to integrate. Two other important examples are cars and drugs, which are the subjects of the next two articles.

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Cure-all wanted

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Europe's market for drugs is singular, not single

JOKERS in the pharmaceutical industry say that the main impact of the euro will be to increase sales of headache pills. In fact, the single currency might make a big difference to the industry, but not in the short term. Its immediate effect will be to draw consumers' attention to the vast price differentials within Europe's health-care systems. In the longer term, it could lead to pressure for harmonisation of social policies within the EU. Before then, however, the euro will act as a stimulus for reform of a notoriously complex system.

So big are drug-price differentials within Europe that an entire industry has sprung up to exploit them. Companies known as “parallel importers” buy drugs in countries where they are cheap, ship them to countries where they are expensive (mainly Britain and Germany), repackage them for the local market and sell them at a profit. At the extreme, a cancer or flu drug might sell for 60% more in Britain than in Greece or Portugal, although the typical differential is more like 30-50%. The market for parallel imports is worth £700m annually in Britain alone. In Germany, pharmacies have been ordered to dispense imported drugs if they offer savings of 10% or more on the local alternative. In Sweden, a ban on parallel imports was lifted in 1995, encouraging an influx that now accounts for more than 6% of the total drugs market.

Parallel importers like to argue that because they are licensed and regulated in the same way as any drug company, theirs is not an arbitrage business but one based on economic fundamentals. To most outsiders it looks simply like regulated arbitrage. Moreover, it has the official approval of the European Commission, which has consistently supported it against the protests of drug manufacturers.

Big drug firms have battled since the 1960s to frustrate parallel importers, but have almost always lost in court. Despite these setbacks, the industry relentlessly appeals against unfavourable court rulings. One company recently tried to introduce a two-tier pricing structure under which wholesalers in Spain paid more for drugs if they intended to sell them for export to Britain. That was ruled illegal. Often the manufacturers try to control supplies in cheap countries, a tactic that has encouraged importers to concentrate on the most important drugs that are easiest to source reliably.

Parallel importers openly admit that their business will not last forever. It would be eliminated overnight if drug manufacturers adopted common prices across Europe. More plausibly, it will gradually come under pressure as countries harmonise the amount they are prepared to pay. How long might that take? Euro or no euro, a decade at least, reckons one of the leading British importers—amply long enough for the business to remain attractive for a while yet.

It's not just drugs

Most consumers will be shocked when the euro at last allows them a clear view of drug-price differentials. However, they will have limited opportunities to conduct their own form of arbitrage, other

than in border regions such as Alsace-Lorraine, where there is already evidence of localised harmonisation.

The main reason why progress is likely to be slow is that the drugs market is closely tied up with health-care systems that vary widely from country to country. Individual governments control reimbursement policies, and drugs are seen as a budgetary expense to be reined in wherever possible. Britain uses a mechanism that caps the profits of drug companies. Most European countries use reference price lists based on average drugs prices in a basket of other countries. France, known as a tough negotiator, has two lists, one for drugs that will be reimbursed by the health-care system, another for drugs that will not be covered. Most countries have imposed across-the-board price cuts at some point in the past decade.

Optimists hope that greater price transparency for drugs will lead to a cascade of pricing harmonisation that will in turn trigger a convergence of social-security and reimbursement policies across Europe. This, along with portable pensions, would help to integrate a supposedly free but in practice highly fragmented labour market. However, national governments are likely to have trouble building a political consensus around common social-protection packages, just as they are having trouble with common financial-protection packages. In both sectors there are massive vested interests to be overcome.

Drug companies argue that the research-based nature of their industry makes it vital to preserve differential pricing. Their prices merely reflect the different purchasing power and health-care budgets of the countries concerned. The implied threat is that in the event of price harmonisation in Europe, the drug companies' R&D capacity will in future be directed towards the more lucrative American market. Europe will lose jobs as well as a precious pool of intellectual property and value creation. Similar threats are beginning to be heard over the prospect of enlargement of the European Union to include countries such as Poland and Hungary, where patents on drugs are harder to enforce than in Western Europe.

However, it is open to European governments to use a range of incentives to make the internal market more attractive to drug companies despite lower overall drug prices. R&D could be encouraged to stay in Europe with the help of tax incentives, particularly for smaller companies that stand to lose most from price harmonisation. Another carrot, already under discussion, would be to relax laws on the way that drugs can be advertised to consumers. At present drug companies in Europe are not allowed to conduct so-called “direct-to-consumer” campaigns for prescription drugs, in sharp contrast with America, where they are common.

More radically, health ministers could overcome their self-interested lethargy and agree to workable common drug-approval processes. Recent disasters such as BSE and foot-and-mouth disease have demonstrated that illnesses do not respect borders, but drugs companies can become tied up in country-by-country approvals, a system that makes little sense. A Europe-wide alternative was introduced in 1995, but if companies choose that, they have to agree to strict branding requirements. Canada offers a useful model, with its federal approval system and strict criteria for review and pricing at provincial level. In Europe such a system would result in big gains for drug companies, because faster and more streamlined approvals would extend their in-patent protection and related monopoly profits.

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Driven to distraction

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Reform of the European car market is overdue

HERE is an example of a made-in-Europe economic absurdity. German consumers can save money by buying cars in Denmark and driving them home, whereas for Danes it is worth crossing the border to have their cars serviced in Germany. The reason is that Denmark imposes a steep tax (of more than 200%) on new cars, which makes for low pre-tax prices attractive to tax-exempt non-residents. By contrast, spare parts and servicing costs in Denmark are the highest in Europe. In Germany, new cars are more expensive, but spare parts are cheaper.

This oddity has been exploited by savvy folk in the Schleswig-Holstein border region for years, but it did not come to broader attention until earlier this year when the Danish Competition Authority published a report on the domestic market for car parts and servicing. It found that manufacturers, importers and dealers were engaging in anti-competitive behaviour. The high prices of spare parts were being used to offset low prices for new cars. Motorists were dissuaded from rebelling by threats that buying parts from non-authorised independent dealers would invalidate their warranties, even if the parts were identical and original.

Such behaviour has been tolerated because Europe's competition laws treat the car industry as a special case. Under the terms of a controversial regulation known as the block exemption, car manufacturers are let off some of the provisions of the Treaty of Rome, particularly those concerning vertical restraints on trade. The car manufacturers' Selective and Exclusive Distribution (SED) system to control distribution of their vehicles and spare parts is legal only thanks to the block exemption.

The industry originally won its exemption by arguing that cars require professional maintenance to ensure their safety. This creates a “natural link” between sales of new cars and the so-called after-care market of repairs and servicing. Only dealers chosen and monitored by the manufacturers can protect this link, the argument went. In return for exclusive territorial rights, dealers represent individual car brands, selling new cars but also offering repairs and servicing. This arrangement produced huge price differentials in different markets. The country most out of line used to be Britain, where average car prices were 30% higher than in continental Europe. Thanks to a sustained campaign, that differential has now narrowed to 15%, but Britain is still known in the industry as “Treasure Island”.

The block exemption was last renewed in 1995, and is due to expire again at the end of September next year. The lobbying has already started. The launch of the euro is a new factor. As in other sectors, it will bring an unprecedented degree of price transparency, not just in the market for new cars, which is already pretty transparent, but also in the lucrative spare-parts market. Can the block exemption survive?

In its present form, almost certainly not. The European Commission has become fed up with manufacturers abusing SEDs. In October it fined DaimlerChrysler nearly *euro*72m for serious breaches of competition rules, mainly in the form of anti-competitive instructions issued to dealers. It has previously fined Opel (part of GM) in the Netherlands and Volkswagen in Germany for similar breaches. Mario Monti, Europe's competition commissioner, has personally championed consumers' right to buy a car in a member state where prices are low, just as he has voiced support for parallel importers of drugs.

Like their drug-industry counterparts, car manufacturers have exploited national market differences to

boost their own profits. They want to keep the block exemption with as few changes as possible, arguing that consumers would be harmed by tinkering with it. ACEA, the European car industry's trade association, hired Accenture, a firm of management consultants, whose report obligingly argued that the best solution for consumers and for competition was to leave the block exemption largely alone.

Block-busting

The commission, meanwhile, pursued its own line of inquiry. Last year it asked Autopolis, an independent British consulting firm, to investigate the claim that there is a natural link between the selling and the servicing of cars. Autopolis's conclusion was stark: the link “is more forced by suppliers than the natural result of market demand,” and is being used to cross-subsidise car sales with servicing revenues, says Graeme Maxton, a director of Autopolis. He describes ACEA's view as “poppycock”, and thinks the car industry would do better to rethink its business models and make them more consumer-friendly.

Autopolis points out that two-thirds of the cars sold in Europe are used ones, for which there are no SEDs. Moreover, roughly half of all servicing and repair is done by independent workshops, outside the franchised dealer networks. Chains of fast fit and repair centres are common in France and Britain, and are increasingly successful elsewhere.

Straight abolition of the block exemption makes sense, but might cause short-term chaos. A transition period would allow time for today's franchised dealers, as well as independent ones, to form all-make networks capable of selling as well as servicing cars. Such networks would want to buy parts from all-makes distributors, which would further weaken the present hold of manufacturers. The networks would be independent but, as Mr Maxton notes, they would in future be on the side of the consumer, not the manufacturer. The level of competition in Europe would rise sharply. Moreover, those manufacturers capable of shifting from a sales culture to a customer after-care culture might find that they could make bigger and more sustained profits.

Car companies publicly continue to support renewal of the block exemption, but behind the scenes they are furiously competing to revamp their marketing strategies. All the signs point towards a more liberal regime that will give consumers more of the benefits expected from a single market. The euro will play only a minor part here. The point is how elusive a single market has proved when leading companies in one of Europe's biggest industries have been allowed to indulge their anti-competitive instincts. It is time for the commission to call them to order.

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Now for the big push?

Nov 29th 2001
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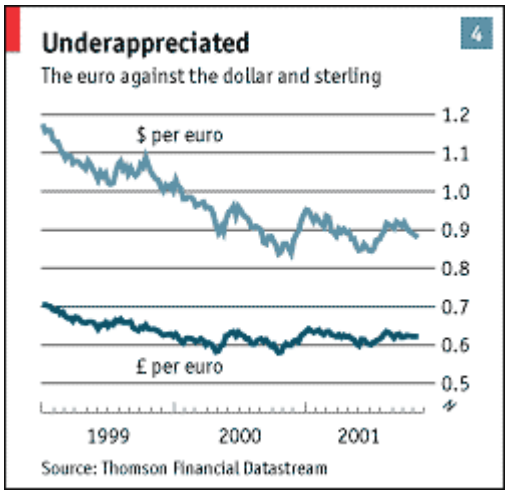
The euro can help to make Europe more competitive, but only if politicians let it



ALBERTO BERTALI is a thoroughly committed European. He is the boss of Hoover, a manufacturer of vacuum cleaners and white goods, now owned by Candy. This Italian family-owned group, based in Monza, bought the then-ailing British company from its American parent six years ago as part of an effort to create a pan-European business. “We thought the business environment in Britain was better than elsewhere,” says Mr Bertali. Its experience since then has been instructive.

The new Italian owner was taken by surprise by the near-35% appreciation of sterling against leading European currencies in less than three years at the end of the 1990s. Its exports fell from 50% of production to 35%. Instead of buying supplies locally in Britain, Hoover started importing them from Spain, Italy and Portugal, countries that were enjoying a 20% cost advantage. “In effect, I had to export British jobs,” says Mr Bertali. He shelved plans to make big investments in Hoover's British factories, and is now looking at investment opportunities outside Britain.

The story neatly sums up the stop-start nature of European economic integration. Strong pan-European intent results in a cross-border acquisition, but is thwarted because a leading economy is separated by its currency from its main continental partners. Companies in two countries suffer. The parent company is in the euro zone, so the subsidiary needs to be fully euro-compatible in order to compete effectively. Britain is in effect being made a euro member by its businesses.

Even now, companies that want to make cross-border mergers or acquisitions face considerable difficulties. Apparently paradigm-shifting deals such as Vodafone's hostile takeover of Mannesmann last year turn out to be one-off exceptions to the general rule that such deals remain hard to pull off.

Thanks to German intransigence, the European Parliament recently threw out a proposal for a takeover directive that had been 12 years in the making. Frits Bolkestein, the commissioner for the single market, was moved to bemoan the prevailing spirit of “atavistic reflexes of a corporatist nature” coupled with “economic nationalism”. The Parliament recently endorsed a European company statute that will give companies the option to incorporate as European entities rather than as national ones, but as long as corporate taxes remain unharmonised it will find few takers.

An analysis of recent merger activity suggests that restructuring still has a long way to go. If there were a single market for corporate control in Europe, it should not matter to companies where a potential target is based. In America, for example, more than half of all deals are made across state borders, and a mere 17% within an individual state (the rest are international). But in Europe, national borders remain important. Last year only a quarter of European deals spanned European borders, and almost 35% were purely domestic. That figure has come down over the past decade, but it remains a long way above its American equivalent.

Unenlightened self-interest

Governments are partly to blame. Although they have privatised state assets aplenty, they have often retained “golden shares” that restrain the usual market disciplines. Worse, national governments have protected their domestic state-owned (or majority state-owned) companies from direct competition, while encouraging them to buy their way into strong pan-European positions. The worst example has

been Electricité de France, protected by France's disgracefully tardy liberalisation of its electricity market, but so aggressive in expanding outside France that it simultaneously caused a political spat in Spain and led Italy to change its laws in order to repel an unfairly advantaged competitor. That might make the company a candidate for privatisation sooner than most observers believe.

This is not to deny that there has been progress. Markets in telecoms and, to a lesser extent, energy have been opened up to good effect. Mr Monti recently pointed out that in most EU member states average charges for international telephone calls fell by 40% between 1997 and 1999. In the more liberalised markets, energy prices have also tumbled.

All the same, governments whose citizens still have much to gain from restructuring often appear to lack the political will for it. Herbert Henzler, a consultant with McKinsey in Germany, argues that the success of the European common market is too easily forgotten: “The mitigation of per-capita income differentials has been enormous.” In 1970, the average income per head in Sweden was seven times higher than that in Portugal. Last year the multiple had come down to three times. But for all its success, says Mr Henzler, Europe faces a difficult future, particularly if it tries both to deepen and to broaden its membership at the same time.

Among the more encouraging developments are the far-reaching tax reforms introduced by Germany's chancellor, Gerhard Schröder, which will begin to come on stream at the beginning of next year. They include a proviso that a company selling shares in another company will escape capital-gains tax. This will set off a flurry of restructuring in Europe's biggest but worryingly sluggish economy, because German companies' balance sheets contain huge hidden reserves derived from long-term holdings of shares in other companies. For example, a share in Siemens acquired in 1974 for *euro*8 still sits on the buyer's balance sheet at *euro*8 today, even though its value has risen hugely. Before the tax reform, selling the share was unattractive because any capital gain was taxed at 50%. In future a sale will be tax-free.

Mark Tinker, an analyst with Commerzbank in London, reckons that around half of Germany's equity market is currently tied up in cross-holdings that might be disposed of once the law changes. That means up to *euro*500 billion could change hands in the next few years as assets are swapped and re-jigged. In theory, the resulting efficiencies should mean that Germany could raise its poor average rate of return on invested capital. That would be good for all of Europe.

The arrival of euro notes and coins, too, is good for Europe and for its businesses. The currency's very existence proves an intent to pursue the single market that has so far been bedevilled by a host of problems and failures. The single currency still lacks a single transmission system. This survey has shown that the currency will nevertheless have an immense impact, changing the way European companies think and operate. Given a single transmission system, the currency could help achieve greater integration, galvanising the European economy into becoming fully competitive. Combined with other structural reforms, it could shape Europe's economic and political future. Europe's political leaders, please note.

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The author would like to thank the many individuals, not all of them quoted in the text, who contributed to this survey. He is especially grateful to various staff members of the European Commission, Insead, IBM Europe and A.T. Kearney for sharing their ideas so generously.

There is a wealth of euro-related information available in printed and Internet sources. Among the most useful are:

"Does a Currency Union Boost International Trade?" research paper by Andrew K. Rose, University of California, Berkeley

"Does a Currency Union Affect Trade? The Time Series Evidence" by Reuven Glick and Andrew K. Rose

"A Prism on Globalization" by Subramanian Rangan, Brookings Institution, Washington, D.C., 1999 (with Robert Z. Lawrence)

"The Euro at the Point of Sale", special report by IBM Europe

"Introducing Euro Notes and Coins to the Public", by Ludo Van der Heyden, Insead Working Paper 2000/20/TM, (2000) (with A. Huchzermeier)

The European Union's euro website

Most central bank websites offer euro-related research. The Bank of England has published a particularly thorough series of reports on "Practical Issues Arising From the Euro" that contains much interesting technical information.

"Political Economy of Financial Integration in Europe: the Battle of the Systems" by Jonathan Story and Ingo Walter, Manchester University Press, 1997, is somewhat dated, but offers an excellent overview of the issues and challenges. Professor Story's subsequent work is also well worth consulting.

A short version of the Autopolis report referred to in the survey is available online, while most other reports mentioned can normally be found at the relevant company website.

The Centre for European Reform has published several useful reports, notably "The Lisbon Scorecard: the Status of Economic Reform in Europe" by Edward Bannerman.

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Outsourcing

Out of the back room

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More companies are farming out their most boring services to specialists

THE human-resources department is rarely a good place to work if you are an ambitious young grafter. Mocked as the “human refuse” department, it is corporate Siberia. Companies see it as gobbling resources that do nothing to improve sales or profits. No wonder some wish it would disappear.

Hence, perhaps, the success of a company that does indeed cause the most repetitive aspects of human-resource management to vanish—by outsourcing them. Exult, set up in 1998 by General Atlantic, a private-equity firm, specialises in running the routine aspects of corporate HR. It has several big clients: BP, Bank of America and International Paper among them. Exult's marketing success (its revenues are rising sharply, although it loses money) have given a fillip to “business process outsourcing” (BPO).

Some of this is old hat. Many companies outsource their payrolls, for example, and buildings management. Insurers outsource claims processing. EDS, a giant Texas company, has been running information-technology services for years. The outsourcing of IT boomed in the early 1990s, thanks mainly to EDS and IBM. Accenture, in the days when it was still called Andersen Consulting, took over part of BP's finance and accounting services.

But all these companies offer other services besides BPO. Many recent arrivals are “pure plays”. An example is Xchanging, a three-year-old British company founded by David Andrews, who learned the job when he was setting up Andersen Consulting's BPO business and then managing the relationship with BP. His company now has deals to run HR for BAE Systems, a leading British defence group, and also premium processing and claims management for the Lloyd's of London insurance market.

The BPO market is still narrow and fragile. Rebecca Scholl, who follows it for the Gartner Group, a consultancy, says that the global BPO market grew by 13% between 1999 and 2000, to $119 billion, and that it will reach $234 billion in 2005. She argues that experience with IT and transaction outsourcing has begun to give companies the confidence to undertake “strategic” outsourcing, handing over more integral aspects of business. But payment services such as credit-card processing and logistics, both long outsourced, will still dominate the market in 2005.

Her forecast is more modest than the one that Gartner was making a year ago. Since then, one “pure-play” outsourcer, LeapSource, has folded. Among the reasons, argues Ms Scholl, were an absence of a large “founder client” and an attempt to win economies of scale by persuading reluctant clients to accept standardised solutions to their problems.

There is still plenty of potential. Individual companies' back offices “are usually too small to reap scale economies,” says Patrick Forth, who used to work for the Boston Consulting Group and now runs iFormation, a high-tech start-up. But lump several together, as BPO firms do, and the picture quickly changes. Mr Forth thinks the economic downturn will be a boon to BPO. There is plenty of room to grow: an article in a forthcoming *McKinsey Quarterly** points out that almost all routine corporate services are still run in-house. Yet the costs of managing outsourced services have recently declined, thanks to cheaper communication, the standardisation of web-based tools and the speed with which companies are automating their own data services.

Talking it through

Behind strategic outsourcing's growth is a realisation that a specialist may be able to provide a routine service at lower cost, and with better technology. There are other benefits. PricewaterhouseCoopers (PwC), an accounting giant, handles BP's finance and accounting, procurement and computer maintenance. “We take their back-office staff and put them into our own BPO company, so that they become our front-office staff, who make the money for us, and are thus more valuable to us than they were to BP,” says Ton Heijman, head of PwC's BPO practice. “Ask a chief financial officer how much time he spends on personnel issues, and he will say 50-60%.” Outsourcing these saves that lost time.

But these benefits do not come easily. Experienced outsourcers emphasise the need to think through the purpose of the exercise. “Don't outsource a problem,” counsels Tony Hayward, group treasurer at BP. It all takes time: PwC reckons on up to a year and a half to get from first contact with a company to final contract, because of the innumerable details to negotiate.

Companies also need to work out a suitable charging structure. Should it be a fixed-cost deal (where all unexpected savings go to the outsourcer) or a joint venture, giving each partner a stake in success? And how far should the client demand a customised solution, tailored to fit its particular needs, or accept a one-size-fits-all answer, which offers greater economies of scale? Mary Lou Cagle, who manages Bank of America's relationship with Exult, recalls how she and her colleagues sat down with their counterparts at Exult and pored over hundreds of business points for six weeks. As this was a ten-year contract, one of the key questions was “what if we decide to get a divorce?”

Faced with such delicate questions, some companies call in specialist advice: for instance, Texas-based TPI specialises in holding the hand of a company negotiating with outsourcers. Mark Hodges, head of strategy and corporate development for TPI, argues that what happens after the deal is even more important than what happens before. But companies may not realise that. “It's a hard row until the client skins his knees a few times,” he says.

The knee-skinning often occurs when costs start to rise, not fall. In general, BPO delivers reductions in unit costs. PwC's Mr Heijman reckons the savings range from 20% to 50%. Efficiency usually improves. International Paper had already raised its HR department from the bottom quartile of big companies, where costs were $1,600 per employee, but it says its deal with Exult will propel it to the top quartile, with costs of $800 per employee. However, the sheer flexibility of the new arrangement may tempt a company to give the outsourcer new tasks not covered in the initial contract. That, says Mr Hodges, means overall costs are usually flat or higher.

Managing a relationship with a strategic outsourcer is far more complex than coping with an ordinary supplier. Bill White, an outsourcing manager at DuPont, one of TPI's clients, argues that the relationship needs to be a partnership, concentrating on outputs rather than on inputs, as in a typical supplier relationship.

What will companies outsource next? Procurement, guesses Mr Hodges. Companies have made big strides towards consolidating procurement on web-based systems, but still run huge departments. And, if there is anywhere more disheartening to work than the HR department, it must be corporate purchasing.

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* “The Other Side of Outsourcing”, by Byron G Auguste, Yvonne Hao, Marc Singer and Michael Wiegand

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Mining

Upping the ante

Nov 29th 2001 | JOHANNESBURG
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An exciting flurry of takeover bids in a normally unexciting business

THE world's two biggest gold producers got hot under the collar this week, trying to woo an antipodean sweetheart. AngloGold bid A$3.2 billion ($1.7 billion) for Australia's largest gold producer, Normandy, in September, as part of its efforts to move production away from South Africa's costly deep mines to cheaper open-cast ones. But it was outshone by a bid, now worth A$3.4 billion, from Newmont, an American rival. So this week Bobby Godsell, AngloGold's boss, plunged into the courts, branding the Newmont bid “misleading”, and then upped his own bid. Why all the excitement?

One reason why Newmont and AngloGold are at each other's throats is that they know the gold industry needs to consolidate. It is too fragmented to organise supply in a way that keeps prices stable. Gold producers are therefore under pressure to save costs by joining together to the same extent as their peers in the nickel, iron-ore and copper mining industries, where the ten largest companies account for well over half of all metal mined. Likewise, a few big groups produce all of the world's platinum. Even aluminium producers are trying to restructure: one of them, Alcoa, has been courting another Australian mining company, WMC.

Who will win Normandy's hand? AngloGold's new bid—a mix of its own shares and cash—is worth A$3.7 billion, and it now has the edge. Mr Godsell argues that AngloGold's proposal makes better business sense because of its existing joint ventures with Normandy and its production and environmental record. He wants Normandy's fate decided one way or another by the end of the year. But Newmont has asked shareholders in the Australian company not to be hasty, suggesting that it might raise its own bid.

This makes the foray into the courts something of a side-show. When Newmont first approached Normandy, it also made a separate $2.6 billion bid for a Canadian mining company, Franco-Nevada, which in turn owns a 20% stake in Normandy. Mr Godsell claims that Newmont's double bid favours some shareholders over others, and thus breaks Australia's stockmarket rules.

AngloAmerican, the South African giant which owns more than half of AngloGold, may be reluctant to enter a protracted bidding contest. But it also knows that, if AngloGold misses out on Normandy, Newmont will become the undisputed industry leader. And there are few dishes as good ready to be eaten, even though Mr Godsell talks airily of “five or six” alternatives. Indeed, speculation has grown recently that Barrick, another Canadian mining company, is eyeing AngloGold itself. Mr Godsell is quick to dismiss this as “rumour”, but he concedes that “consolidation will continue if it produces value”. Expect plenty more deal-making among the big diggers.

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Corporate alumni networks

Keeping in touch

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Companies are finding new ways to keep tabs on former staff

WHEN he left American Express 17 years ago, Michael Strauss realised the value of the network of people he had worked with. Now chairman of the Sherwood Group, a bank, he has kept in touch with many ex-colleagues. However, when he needs to track down somebody specific, he sometimes has to make a string of calls to locate them. Former employees of Six Flags Over Texas, a 40-year-old theme park, are luckier. One of them has set up a lively contact website, so that, for instance, Kathy Black, who worked on the front gate in 1963-64, can locate old chums who recall those golden days.

For many firms, websites for ex-employees are a good way to keep tabs on folk who may one day be useful. Consultancies, with their high turnover of keen youngsters, are especially good at this. For example Bain, with 27 offices around the world, has a site crammed with news of former staff. It offers links to headhunters and a job bank (both are useful as the market turns sour). Cindy Jackson, director of alumni relations, reckons that 70% of former Bain staff are on the database.

As more staff become ex-staff, more companies want to use such techniques to keep a link with the intellectual capital they are having to disperse. Two years ago, Cem Sertoglu and a group of fellow management consultants set up SelectMinds to specialise in creating and managing networks of former employees. Nifty software allows a company to communicate differently with different groups of ex-staff: one way with people who worked together briefly on a project, say; another with retired executives. Since the job market has sagged, says Mr Sertoglu, demand for the service has grown.

One of his customers is Oliver Wyman, a financial-services consultancy. Matthew Cunningham, a director, realised some months ago that the number of ex-employees had overtaken the firm's current staff numbers of almost 400. In July, Oliver Wyman launched an alumni network, mainly as a recruiting vehicle. It offers a link with clever youngsters who leave for academic life or to launch their own start-up. It is also a way to get recommendations when the business is hiring (as it still is). Mr Cunningham hopes it may one day become an “intellectual-capital community”. That sounds a cut above a trip down memory lane at Six Flags Over Texas.

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Formula One

End of the road?

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A proposed new motor-racing championship puts Kirch in a dilemma

AFTER months of apparent posturing, Paolo Cantarella, the chief executive of Fiat, announced this week that the car manufacturers involved in Formula One (F1) will set up a new motor-racing series—apparently to be known as the Grand Prix World Championship—and will pull out of F1 in 2008. Mr Cantarella was speaking for a consortium comprising BMW, DaimlerChrysler, Fiat, Ford and Renault, which back five of the 12 F1 teams. Fiat owns Ferrari, a name synonymous with F1.

AP

Will the teams drive away?

The car makers first threatened a breakaway in February when the Kirch Group, owned by Leo Kirch, a German media magnate, bought a big stake in SLEC Holdings, a group of companies that owns a large part of the commercial rights to F1. Mr Kirch gained control of SLEC (he owns 58.3%) in October, when the family trusts of Bernie Ecclestone, a controversial British entrepreneur who has run F1 since the 1970s, gave the necessary approval. The teams are bound to the current championship until the end of 2007 when the Concorde Agreement, a ten-year arrangement governing the relationship between the teams and SLEC, expires.

The car makers object to Mr Kirch's control of F1, ostensibly on the grounds that he has not reassured them that coverage will remain on free-to-air TV in the long term. (Mr Kirch controls Germany's only national pay-TV network.) F1's main selling-point to the car makers is the size of its global free-to-air TV audience. But the car makers, as the main backers of F1, also want more control over how it is run. They invest hundreds of millions each year in the sport but have little or no say over its business side.

There is also the issue of the fat share of F1's revenues allocated to SLEC under the Concorde Agreement. SLEC pays the teams only 47% of F1's gross television revenues and retains all the highly profitable fees paid by promoters to stage grand prix. The car manufacturers want more of these revenues for the teams. And they object to other, even murkier aspects of F1's finances. Most promoters of grand prix give Allsport Management, a Swiss company whose beneficial ownership is impossible to establish, the right to sell trackside advertising. *The Economist* estimates that the revenues from this advertising are $75m-100m a year. None of this money goes to the teams.

The proposed new series leaves Kirch in a terribly weak position. “After 2007, Mr Kirch has nothing to sell that the car makers cannot create for themselves,” says one executive involved in the new series. Mr Kirch paid $1.54 billion for his stake in SLEC. If the new series goes ahead, the F1 brand would be virtually worthless.

To avert the launch of a rival series, however, Mr Kirch would have to accede to the car makers' demands. This would mean surrendering after 2007 a large part, if not most, of the cashflow that SLEC currently enjoys. Such a move would greatly reduce the value of his stake in SLEC. So to save F1, Mr Kirch may have to admit that he has paid a high price for an asset that will have little value after 2007.

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Asian trade unions

Getting organised, with western help

Nov 29th 2001 | TANGERANG, WEST JAVA
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Multinationals are pressing their Asian suppliers to tolerate unions

AP

From slave to shop steward

IN 1997, Lalita Mahendramurty, a human-rights manager at Reebok, an American sportswear giant, started visiting Dong Joe, a South Korean-owned factory in Indonesia that makes shoes for Reebok. Her job was to ensure that Dong Joe's managers did not abuse their workers. Then she had a mischievous idea. On paper, all factories in Suharto-era Indonesia were supposed to belong to the government-approved national labour union, so Ms Mahendramurty demanded to see its office. It turned out to be a storage room filled with cobwebs an hour's drive away. Ms Mahendramurty insisted on meeting the union's leaders. None, she discovered, knew he was a union leader—or, indeed, what a union was.

Much has changed since then. Soon after Suharto fell from power in 1998, Indonesia ratified international conventions enshrining freedom of association. Reebok immediately organised seminars to teach Dong Joe's workers about union organisation and collective bargaining.

Then, last May, the union held its first free leadership election. But it still has teething problems. Mohammed Toneko, its leader, frets that the union has no industrial-action fund for workers, and so cannot afford the necessary strike pay. Even so, he is increasingly winning concessions. Recently, he saw to it that a security guard who had forced a worker to pull down her pants was fired. Ms Mahendramurty, for her part, needs to visit rather less often nowadays, because the union keeps her abreast of abuses.

Dong Joe is but one example of a new approach by western brand owners such as Reebok, Nike and Adidas to managing their so-called sweatshop problem. This marks a fourth phase in the decade or so since western consumer groups first threatened to boycott the brands for exploiting cheap third-world labour. The first phase, in the early 1990s, was denial. The second was to press suppliers to respect human rights, and to try to police their factories. The third, since the late 1990s, has been to make these inspections more credible by hiring independent monitors.

These three phases were all failures. Denial backfired, as pictures of young children stitching footballs took their toll. And monitoring, even by independent auditors, can be got around: factory owners can stage-manage compliance during inspections (by selecting, coaching and frightening workers before interviews). Hence the need for a new approach. The goal now, says Jill Tucker, who is in charge of Reebok's human-rights strategy in Asia, is to emancipate workers so that they can stand up for themselves.

Reebok calls this “worker participation” rather than unionisation, since many governments in Asia will not stand for the second. Traditionally, unions in the region have been “yellow” rather than “red”—meaning that they have not been allowed to elect leaders, bargain collectively or strike. Instead, they were fig leaves for authoritarian governments. Unions in South Korea and Taiwan got redder only after these countries became democratic a decade or so ago. The same is now happening in Indonesia.

However, the trend towards redder unions is running behind economic realities. Workers in South Korea and Taiwan organised only after most sweatshop industries had moved to cheaper locations in South-East Asia. The same fate may now befall South-East Asia, as labour-intensive industries move to China,

which already makes 95% of America's stuffed toys and 60% of its shoes.

China is, moreover, a special case. Officially a workers' paradise, in reality millions of its state-sector workers are being laid off and left to roam the country in search of migrant jobs. This frightens the leaders in Beijing. They have no intention of allowing their yellow union—the All China Federation of Trade Unions (ACFTU)—to break up into independent unions that might actually speak up for workers. The ACFTU's 100m “members” tend to know nothing about it except that it provides one ticket a week for the screening of a propaganda film.

Several western brand owners recently lobbied Jiang Zemin, China's president, to adopt international covenants on the freedom of association. Mr Jiang flatly refused. Nonetheless, they feel they must be seen to care for workers in their supply chain, so the more pioneering among them have experimented in legal grey areas. In July, for instance, Reebok organised an election at a shoe factory in southern China, where workers for the first time chose their own representatives.

This is, in fact, a big step. Many workers in Asia either do not know their rights or are afraid to push for them. So they need education and encouragement. This does not have to come from multinationals. Han Dongfan, a prominent Chinese labour activist, even thinks that too much coddling by the multinationals of workers in their own supply chain could demoralise the millions of workers who work in the purely domestic sector and have no foreign help to turn to.

Multinationals do have a unique role to play, however, since often only they have the power to cajole governments or local capitalists into letting workers organise. European and American workers took almost a century after the industrial revolution to build the institutions that today work to defend their rights, and some expect that it will take Asians just as long. If they do it any faster, it may be thanks to a global web that links a girl in Guangdong stitching trainers, via a brand owner concerned about its image, to the social conscience of a teenager walking into a store in New York.

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Kvaerner

Rokke to the rescue

Nov 29th 2001 | PARIS
From The Economist print edition

A fading giant merges with an old foe to stave off bankruptcy

AFTER weeks of suspense, the capitulation came suddenly: on November 28th Kvaerner, a huge but loss-making Anglo-Norwegian engineering group, agreed to a rescue merger with Aker Maritime, a Norwegian oil-services group. Kvaerner had tried to avoid falling into its old rival's arms, but the alternative was immediate bankruptcy. Even so, the NKr3.6 billion ($400m) shares-and-debt transaction was hard for this once great company to swallow. In the past it has held abortive merger talks with Aker. It then feuded in public with Kjell Inge Rokke, Aker's aggressive and outspoken boss, who has gained a reputation in his native Norway as a tough corporate raider.

The bad blood between the two companies has made the denouement dangerous for Kvaerner, but it had little choice. The reason is that Aker is its biggest shareholder with almost 25%. In the end, Mr Rokke got his way by simply threatening to vote down a proposed rescue put together by Yukos, a Russian oil group, tabling his own offer instead.

Yukos's plan involved a rights issue and a scheme that would have allowed Kvaerner's creditors to convert debt into equity. Yukos, however, also had little choice but to bow to Aker, despite owning a 22% stake in Kvaerner. Mr Rokke has driven a hard bargain, scrapping the debt-for-equity swap and lowering the price of a planned rights issue.

Creditors could yet rebel and scupper Aker's offer; or the European Commission might object. But the alternative is so stark that Mr Rokke will probably bag his prize. He will be ruthless thereafter, selling or closing Kvaerner's weaker operations. At its peak, the company employed 80,000 people, having bought businesses all over the world, including Britain's Trafalgar House. It still has 34,000. They will be watching Mr Rokke's next moves with trepidation.

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A global ranking of companies

Marked by the market

Nov 29th 2001
From The Economist print edition

Which of the world's leading companies have created the most wealth for their shareholders? Stern Stewart's Wealth Added Index seeks to provide an answer

THE world's stockmarkets have taken investors on a bumpy ride over the past five years. American equities saw unprecedented gains before the bubble burst last year. European bourses, fuelled by a blooming equity culture, rose in sympathy only to have their hopes of American-style riches dashed. Japan's stockmarket continued its slide, and remains down by more than 70% from its 1990 peak, and emerging stockmarkets fell even further out of fashion. Look beyond the broad indices, though, and the picture is more nuanced. Some companies have created great wealth for their shareholders, while others have destroyed vast amounts.

First, a note of caution: any league table based on share values should be treated with some scepticism. Market gyrations can scramble rankings faster than they can be printed. Even so, a long-term global perspective can give a much-needed view above the daily market clamour.

One attempt to gain such a view is the Wealth Added Index (WAI), compiled by Stern Stewart, a consulting firm, and published here for the first time. This ranks the world's 5,069 largest quoted companies by shareholder wealth created (or destroyed) between June 1996 and June 2001. Central to the WAI rankings is the idea that companies create value for shareholders only if their returns to investors—from share-price rises and dividends—exceed their “cost of equity” (defined as the minimum return that investors require for putting their money in risky shares).

For richer...

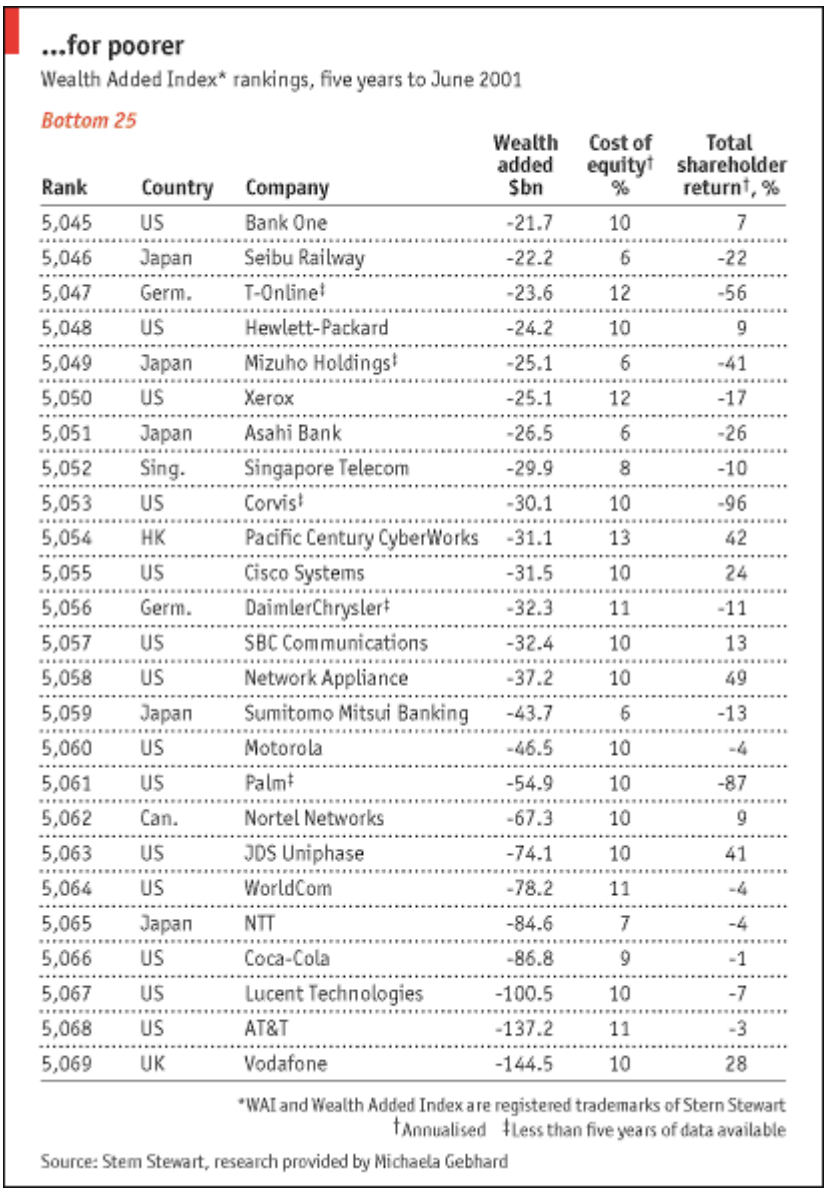
Wealth Added Index* rankings, five years to June 2001

Top 25

Rank	Country	Company	Wealth added $bn	Cost of equity† %	Total shareholder return†, %
1	US	General Electric	226.8	10	28
2	US	Microsoft	149.5	11	37
3	Germ.	Mannesmann	120.9	9	51
4	US	Wal-Mart Stores	118.3	9	32
5	US	Citigroup	113.1	10	37
6	US	IBM	106.9	11	36
7	Fin.	Nokia	85.0	10	74
8	US	AIG	81.3	10	30
9	Japan	NTT DoCoMo‡	78.8	6	10
10	US	AOL Time Warner	67.8	9	81
11	US	Oracle	65.5	11	34
12	UK	Royal Dutch/Shell	63.7	10	21
13	UK	Unilever	53.3	9	19
14	US	Home Depot	50.5	9	32
15	Switz.	Nestlé	43.8	6	23
16	US	Pfizer	43.6	9	29
17	US	Dell Computer	42.9	10	75
18	US	Amgen	38.0	9	35
19	Neths	ING Group	37.0	10	30
20	US	Morgan Stanley Dean Witter	36.5	9	36
21	US	Exxon Mobil	36.2	9	18
22	US	Johnson & Johnson	34.6	9	17
23	Italy	Telecom Italia	33.9	11	37
24	Japan	Toyota Motor	33.7	6	11
25	Swed.	Ericsson	32.7	10	29

*WAI and Wealth Added Index are registered trademarks of Stern Stewart
†Annualised ‡Less than five years of data available

Source: Stern Stewart, research provided by Michaela Gebhard



...for poorer

Wealth Added Index* rankings, five years to June 2001

Bottom 25

Rank	Country	Company	Wealth added $bn	Cost of equity† %	Total shareholder return†, %
5,045	US	Bank One	-21.7	10	7
5,046	Japan	Seibu Railway	-22.2	6	-22
5,047	Germ.	T-Online‡	-23.6	12	-56
5,048	US	Hewlett-Packard	-24.2	10	9
5,049	Japan	Mizuho Holdings‡	-25.1	6	-41
5,050	US	Xerox	-25.1	12	-17
5,051	Japan	Asahi Bank	-26.5	6	-26
5,052	Sing.	Singapore Telecom	-29.9	8	-10
5,053	US	Corvis‡	-30.1	10	-96
5,054	HK	Pacific Century CyberWorks	-31.1	13	42
5,055	US	Cisco Systems	-31.5	10	24
5,056	Germ.	DaimlerChrysler‡	-32.3	11	-11
5,057	US	SBC Communications	-32.4	10	13
5,058	US	Network Appliance	-37.2	10	49
5,059	Japan	Sumitomo Mitsui Banking	-43.7	6	-13
5,060	US	Motorola	-46.5	10	-4
5,061	US	Palm‡	-54.9	10	-87
5,062	Can.	Nortel Networks	-67.3	10	9
5,063	US	JDS Uniphase	-74.1	10	41
5,064	US	WorldCom	-78.2	11	-4
5,065	Japan	NTT	-84.6	7	-4
5,066	US	Coca-Cola	-86.8	9	-1
5,067	US	Lucent Technologies	-100.5	10	-7
5,068	US	AT&T	-137.2	11	-3
5,069	UK	Vodafone	-144.5	10	28

*WAI and Wealth Added Index are registered trademarks of Stern Stewart
†Annualised ‡Less than five years of data available

Source: Stern Stewart, research provided by Michaela Gebhard

For all companies, the cost of equity on this basis ought to be greater than the return that is available from a riskless alternative such as government bonds. And the greater the risk investors bear, the greater the returns they should require. If a firm's returns do not exceed the cost of its equity, shareholders' capital could be better used elsewhere. In Stern Stewart's analysis, companies whose share values not only grow, but grow by more than the return required by investors, are creating value; those that return less, over time, are destroying it.

Risky business

The trickiest part of this calculation is to work out this “required return”, taking into account a company's riskiness. A company's capital typically consists of a mixture of debt and equity. Debt has an obvious cost: the interest rate on a bond or loan. The cost of equity is less simple. For this, Stern Stewart relies on the Capital Asset Pricing Model (CAPM). The CAPM, a cornerstone of corporate-finance theory, is more commonly used to analyse large portfolios of shares than individual companies. Still, everyone agrees that equity capital has an economic cost—though the dotcom boom made it seem free for a while—and the CAPM is a widely used way to measure it.

Another caveat is that Stern Stewart's WAI assumes that stockmarkets are efficient in the narrow, academic sense, meaning that all investors are rational and agree on the best way to measure risk. Many market observers would question that assumption, especially after experiencing the technology bubble. Moreover, the WAI is skewed by size: big firms tend to add or destroy more wealth, because the index is expressed in absolute terms rather than in percentage outperformance.

Against these caveats, the WAI has several virtues. One is that it avoids the pitfalls of the majority of benchmarks which are relative measures within an industry. These can be misleading since they always

produce some winners, even if every company in the industry does badly for its shareholders (consider airlines and film studios). Because it does not depend on reported profits, the index also avoids tricky cross-border accounting differences that bedevil Stern Stewart's other popular measure of returns, economic value-added (EVA). Comparative EVA figures can be produced only for individual countries, not for the world as a whole. The WAI also gives an alternative view to “total shareholder returns” (TSR), a common metric of share performance that reflects the returns to “buy and hold” investors.

An investor who has held shares in Britain's Vodafone ever since June 1996, for example, has chalked up a 248% TSR. But Stern Stewart's methodology, which takes into account those who bought during the period as well as those who held throughout, produces a startlingly different result. It reckons that overall Vodafone destroyed some $145 billion between 1996 and 2001, more than any other company in the study. Most of that value was lost as Vodafone bid dearly for third-generation (3G) mobile-phone licences and paid a hefty price for Mannesmann, a German group. Vodafone's loss was Mannesmann's gain; the German company ranks as the world's third-biggest wealth creator over the same period, with $121 billion of gains to its credit. This seems to confirm Warren Buffett's observation that shareholders of target companies are the only winners in mergers.

In general, telecoms companies feature prominently among the biggest wealth destroyers. AT&T is responsible for vaporising $137 billion, thanks to its failed forays into broadband and data, along with a devastating price war in its core long-distance markets. Lucent Technologies, spun off from AT&T in 1996, is also among the worst performers, having laid to waste $101 billion as its networking-equipment market collapsed.

The big American car makers also did badly. DaimlerChrysler, conceived in 1998, ranks 14th from bottom, with an average annual return of -11%, the mirror image of its cost of equity. Ford and GM have also been plagued by overcapacity as well as by costly acquisitions in Europe. GM's average annual return of 13% is respectable, but does not meet its 15% cost of equity. European and Japanese car makers, though smaller, did far better; Toyota, BMW, PSA Peugeot Citroën and Renault together added around $50 billion in wealth.

General Electric is the clearest winner. Its strategy of striving to be number one or two in each of its business lines apparently paid off with $227 billion in wealth creation over the period. But even the legendary Jack Welch is not perfect. Between June 2000 and June 2001, GE's shares fell short of investors' required return by ten percentage points.

Another winner—and a glaring exception to the dismal record of telecoms firms—is NTT DoCoMo, Japan's only entry in the top ten. Its high placing is largely thanks to the Japanese government, which gave the firm its 3G licences free.

Nearly all the companies in the top 25 ran into a snag in at least one of the past five years. Microsoft, for example, saw its shares knocked down by its battle with antitrust regulators, yet still managed to be the world's second-biggest wealth creator. Citigroup has the only unblemished record in the table, having added value consistently throughout the period. The giant American bank delivered an average annual return of 37.3%, nearly four times its cost of equity.

Europe soars

The gospel of shareholder wealth has been preached nowhere more loudly than in America. Yet, surprisingly, a look at Stern Stewart's rankings by region reveals that American companies have done less well than their investor-friendly talk might suggest (see chart). As a group, they have barely delivered returns above their cost of equity. Since wealth destroyers' losses offset the gains from wealth creators, America's companies have created only $199 billion in wealth. Even worse, they have returned less than four percentage points above the cost of equity on average.

Europe trumps America on both measures, producing a five-year return of 56 percentage points above the cost of equity, and $1.1 trillion in added wealth. One possible reason is Europeans' smaller appetite for big mergers. Another is that Europe was less gripped by the technology frenzy that led to overinvestment in America.

Unsurprisingly, Japanese companies performed dismally. In most large Japanese businesses, the notion that capital has a cost at all is still new. Cross-shareholdings have ensured that capital was allocated with extraordinary inefficiency. As a result, the country's companies have returned around 34 percentage points below the required return.

One lesson from the rankings is that costly acquisitions are a good way to destroy value. Another is that volatile markets can quickly turn a wealth creator into a wealth destroyer. As the recent woes of the telecoms industry suggest, the quest for shareholder value creates as many spectacular failures as successes.

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Face value

Bringing home the bacon

Nov 29th 2001
From The Economist print edition

Joseph Luter's Smithfield Foods has become a shining star in a dull industry

HE RUNS a business with annual turnover of $6 billion from an armchair in his Manhattan apartment. He has a telephone, a tattered address book and maybe, somewhere, a pen. There is no computer, and not even any assistants to boss around. “I am not interested in running a company. I am interested in building one,” explains Joseph Luter.

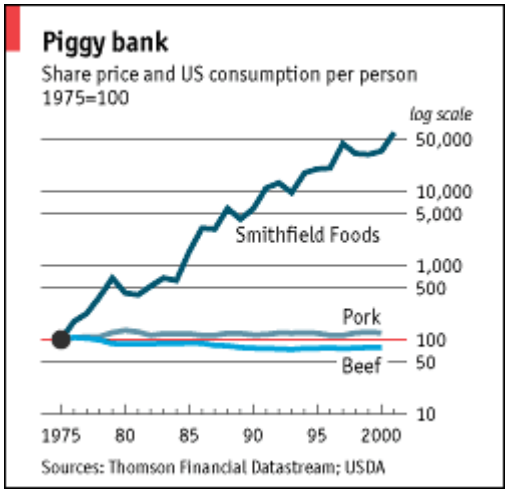
Smithfield Foods may be one of the largest companies in the world to be run by remote control. Mr Luter directly approves every acquisition and all capital spending in excess of $1m. He receives monthly financial statements from 20 division heads, and is available in case of trouble, but the rest of his time is spent thinking about Smithfield's future.

Since 1975 Mr Luter has plunged Smithfield ever deeper into an unfashionable industry, turning it into the world's largest pork producer and processor, and the fourth-largest beef processor. Heading this kind of enterprise requires knowing the gritty details. Fortunately, notwithstanding his smart Manhattan address, Mr Luter learned the dynamics of the slaughterhouse early on.

His grandfather founded Smithfield and his father ran it. School holidays were spent working in the company's meat-packing plants. When his father died suddenly in 1962, Mr Luter, then 23, was summoned home from college to take control. Seven years later he sold out to a conglomerate, which quickly fired him and, rather more slowly, wrecked the company. In 1975 he returned in exchange for an employment contract almost entirely composed of stock options.

Since then, Mr Luter has moved to roll up the industry. According to the Federal Reserve Bank of Kansas City, the number of American slaughterhouses for cattle and pigs has declined by two-thirds since 1980. Mr Luter has played a part in that process. In the past two years alone, Smithfield has made 17 acquisitions, giving it 20% of the domestic processing market for pork. It hopes to push that to 30%, antitrust regulators willing. American antitrust law was created in 1890 out of concern about the meat-packing industry. If the Clinton administration were still in office—and if its chief antitrust enforcer, Joel Klein, had not gone on to be a lawyer for, among others, Smithfield—there might be impediments ahead.

It would be hard, though, for anybody to claim that the industry either lacks competition or is awash in profits. Annual consumption of pork by Americans has not changed much in decades; consumption of beef has declined (see chart). Population growth has provided a bit of a boost, but Americans have long spent a shrinking proportion of their income on food. All too often, optimism about the industry's future has proved costly.



Thus, reacting to what it perceived to be improving conditions, Morgan Stanley, an investment bank, managed to lose $200m by investing directly in the industry between 1991 and 1996. Early this year, Smithfield lost out in a takeover battle for IBP, another giant meat processor, trumped by a $4.7 billion bid by Tyson, which then attempted, unsuccessfully, to scrap its offer after claiming that IBP had not revealed the true extent of its liabilities. Tyson's share price and profits have since taken a pounding.

The industry must also deal with environmental concerns. Pigs produce two to three times more waste than people do. So running large facilities is controversial, to say the least. North Carolina, where

Smithfield has its largest operations, recently put a cap on new plants. Several states have banned large-scale pig farming altogether. This is all nonsense, says Mr Luter. Concentrating production in big farms boosts efficiency and also encourages organic farming, he argues. This may be true, but it has not saved the company from pollution-related litigation.

As the meat business has become more capital-intensive, Mr Luter has had to make some bold moves. Mystified by higher pork consumption overseas in the 1980s, he says that he went to Europe and found the answer: American pigs were second-rate. So, in 1990, he had 2,000 particularly fine British sows loaded on to a specially chartered Boeing 747 and flown to America, where they were crossbred. There are now 385,000 of these sows, producing half of all Smithfield's (now much leaner) meat. These are at the heart of Mr Luter's effort to integrate vertically and to create a nationwide brand, a strategy already common in poultry. This has steadied Smithfield's profits, but it has also antagonised small pig farmers and independent plants.

Where's the fat?

For all this effort, Smithfield's profit margins are minuscule, rarely rising above 3%. In one respect, though, low margins are good. Companies in exciting new industries may enjoy big margins and explosive revenue growth, but these attract both capital and competition. In pork production, the deterrents to entry—from slim margins to environmental restrictions—are daunting.

For Smithfield itself, the low margins are tolerable as long as there are prospects for revenue growth, whether through innovation or through acquisitions as struggling competitors bail out. Europe is Mr Luter's latest hunting-ground: two years ago, Smithfield acquired Animex, a giant pork processor in Poland, a place of cheap grain, cheap labour and, possibly in 2005, entry into the European Union, a vast, high-cost market.

There is, however, no long-term masterplan. “I do not have a five-year or ten-year plan. I take opportunities,” says Mr Luter, and the results speak for themselves. Since he became chief executive in 1975, Smithfield's net worth has grown by a staggering 31% a year, and its share price by 28% a year—a performance that not even General Electric can match. Conventional businessmen flock to high-margin, high-glamour industries. Mr Luter's experience suggests they may be better off going the other way.

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Enron's fall

Upended

Nov 29th 2001 | NEW YORK
From The Economist print edition

AP

How customers, financiers and the rating agencies stopped believing in Enron

Get article background

ONLY last February Enron had a stockmarket value of $60 billion. Now, shareholders are expected to get nothing out of a bankruptcy filing. Barely a year ago, Kenneth Lay, Enron's founder, was being touted as the next energy secretary. Now, his career as an innovative entrepreneur has ended in failure.

The giant energy and financial-trading business—in effect, a hedge fund with a gas pipeline on the side—was dealt an apparently mortal blow on November 28th, when Standard & Poor's, a rating agency, downgraded Enron's debt to junk status. It did so because of the perceived reluctance of Dynegy, a smaller energy rival, to go ahead with a promised takeover of Enron. The downgrade, in turn, removed any remaining doubts that Dynegy may have had about abandoning its bride at the altar. With the merger off, and no sign of another rescuer, Enron's bankruptcy seems the only possible outcome.

Enron was the dominant trader in the markets for energy that had been spawned by electricity deregulation in America. It bought and sold contracts on gas and electricity, among other things, and made markets in financial derivatives related to the energy markets. Increasingly, though, it traded purely financial products, including credit derivatives. Enron, in effect, was abandoning its roots as an energy provider in favour of becoming a Wall Street trader that just happened to be based in Houston, Texas.

Its failure, then, has more in common with that of Long-Term Capital Management (LTCM), a hedge fund run by Nobel prize-winning economists and other geniuses, than with that of PG&E, a California electricity utility that recently went bust. Like LTCM, Enron was admired for its innovative use of financial theory and for its risk-management skills—until it was too late. Enron's financial dealings were hugely complex. They will take many months to unravel. Only then will the consequences of Enron's failure be clear for the firms with which it had dealings, and for the American and world financial systems as a whole.

The suddenness of Enron's collapse raises the possibility of big, as yet unreported, problems inside the firm. Transparency was never Enron's strong suit. The revelations that sparked the crisis in October, about off-balance sheet partnerships, accounting restatements and an investigation by the Securities and Exchange Commission, were embarrassing, certainly. They were not, on the face of it, sufficient reason to close the firm down.

It may emerge that Enron had built up huge trading losses. Paul MacAvoy, an economist at Yale School of Management, fears that just as LTCM (against the advice of its Nobel laureates) abandoned its disciplined approach to trading when things got rough, so Enron may have started taking riskier bets this summer, just as gas and electricity prices fell. Hedging strategies—Enron's supposed core competence—that work well in rising markets can break down when prices fall, especially when the hedger has a net long position, as Enron apparently did.

At the very least, it seems that news of irregularities created a flicker of doubt about Enron's survival among many of those with whom it did business. Accounting irregularities, however modest, are often the miner's canary. Enron's was always a potentially explosive situation, given its aggressive reputation for booking early its profits from trades. Besides, few outsiders understood well what Enron did, or had a full picture of the risks it ran.

Like many financial firms, only more so, Enron built its success upon a confidence trick. While people believed in it, it could prosper. But as soon as its credibility was in question, its position crumbled. It seems that Enron got through $5 billion in the past month, paying off clients. That was not enough to stop them from withdrawing their business.

Wall Street thought that it had devised a way to stop the run on Enron, by arranging for it to be bought by Dynegy, which is backed by Chevron, a huge oil firm; and by arranging equity stakes, each worth $250m, for J.P. Morgan Chase and Citigroup. But this merger, as one of the bankers involved puts it, never created the “halo effect” that everybody wanted. Dynegy never gave the impression of being terribly keen on the deal, despite the bullying by bankers. For one, rafts of lawsuits seemed inevitable, from Enron's shareholders, its pensioners (whose fund had invested in Enron shares) and others. There were also fears that the rating agencies might downgrade Enron's debt despite the Dynegy deal.

What happens next is hard to predict, not least because of Enron's opaqueness. If nothing else, the on-off marriage with Dynegy bought time for firms to reduce their exposure to Enron. That has probably ensured that there is little systemic threat to the financial system of the sort once posed by LTCM. There are even hopes of minimal disruption to the energy market, and thus to the real economy.

Although no other company has yet been downgraded because of its exposure to Enron, there must be something like 1,000 firms that are vulnerable as counterparties to it; many will suffer inconvenience, and not a few outright losses. Dynegy probably has the largest exposure to Enron among energy companies. Its net exposure is said to be $75m; the gross sum is much higher, which may matter more in a bankruptcy if creditors are only partially reimbursed on their claims.

Losses among financial firms may be higher. J.P. Morgan Chase is believed to be on the line for as much as $400m, through non-secured direct loans and trades, as well as another $400m in loans secured by Enron's gas-pipeline subsidiary. Citibank, and to a lesser extent Bank of America, are also widely believed to have deep relationships with Enron.

Enron's fall will be felt in the business of “structured finance”—that multi-billion dollar world of collateralised debt obligations and asset-backed securities. Enron was a big supplier of credit insurance to these products, and, according to Charles Peabody of Ventana Capital, there will be many investors who thought they had protection who find they do not.

All the same, Enron has less power to wreak havoc than LTCM had. In the hedge fund's case, the Federal Reserve, fearing for the financial system, brokered a rescue. That is not on the cards for Enron. But senior Fed officials do worry that such a highly leveraged company as Enron escaped regulatory oversight. The challenge, as they see it, is to remedy that before the next Enron comes along.

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The yen

Let it fall?

Nov 29th 2001
From The Economist print edition

Talk returns of devaluing the yen, as a way to break Japan's deflation

OVER the past week the yen has begun to slip, after hints that the American government may at last be willing to tolerate a fall in its value against the dollar. A depreciation has always been ruled out by the Bank of Japan. “No matter how much water is poured on a dead plant, it simply will not grow,” said the central bank's governor, Masaru Hayami, a few months ago. Monetary policy, he has argued, can do no more to revive the economy until a dysfunctional banking system is cleaned up, and businesses are restructured.

Desperate times, though, call for desperate measures, and the economic news is grim. In the year to October, industrial production fell by 11.9%, while retail sales fell by 4.9%. Persistent deflation in Japan creates new bad debts in the banking system almost as fast as old ones are being written off. It encourages households to put off spending. And it increases the real burden of both public- and private-sector debt. This week two credit-rating agencies downgraded the country's long-term debt.

Foreign economists have long urged the Bank of Japan to pursue aggressive “quantitative monetary easing”—that is, to print money. This the central bank has done since the spring, but only half-heartedly. Injecting any more liquidity into the system, it argues, will do little if banks will not lend. Certainly, two of the usual channels through which monetary policy takes effect are blocked: interest rates can go no lower, and banks saddled with bad loans are reluctant to lend more. All the same, a third channel, the exchange rate, remains open. A cheaper yen would boost exports and, through higher import prices, presumably push up inflation.

Foreign-exchange intervention to lower a currency is far more effective than intervention to support one. In supporting a currency, the central bank quickly runs out of reserves. To send the yen lower, the Bank of Japan could print unlimited amounts of yen to buy dollar bonds. (In theory, this requires the agreement of the Ministry of Finance, which officially controls foreign-exchange reserves.)

Lars Svensson, at Princeton University, favours a big depreciation of the yen to push up prices. He proposes that Japan should first set a target for the level of consumer prices, one that would rise over time to allow for a small positive inflation rate. Japan should then use intervention in the foreign-exchange markets to push the yen sharply down, and to hold it down until prices reach their target level.

A price-level target differs from an inflation target, which other economists propose. If inflation one year undershoots its target, that is ignored in setting policy the next year. On the other hand, if prices fall below the target level, this must be made up in future years—more effective, in principle, for breaking persistent expectations of deflation.

Mr Svensson argues that the yen needs to be pushed to an undervalued level, from which the public would then expect an appreciation of the real exchange rate. With the nominal exchange rate held down by intervention, this could only come about through a rise in prices, creating expectations of future inflation and so reducing real interest rates.

Would it work? Mere mortals may not understand the link between the exchange rate and inflation. If

expectations about inflation are not significantly altered, and policy has to work through the direct impact on consumer prices alone, a huge fall in the yen would be needed, since imports are equivalent to less than 10% of Japan's GDP. Economists reckon that the yen would need to fall to ¥170-180, from ¥124 today, to lift inflation to 1-2%.

It is unlikely that America would tolerate such a drop—and nor would the rest of Asia. Chinese officials have repeatedly expressed concerns about a sharp fall in the yen, though they are surely exaggerating. Japan's imports from China have risen strongly, and Chinese and Japanese exports do not really compete.

Nonetheless, at home and abroad there seems scant appetite for a cheap yen. Japan's Ministry of Finance said this week that it had no intention of driving down the yen by buying American Treasury bonds. At the Bank of Japan's October monetary-policy meeting, Nobuyuki Nakahara, one of the independent members of the bank's policy board, proposed that the bank set a price-level target and examine ways to buy foreign bonds. He was voted down, by eight to one.

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Japan's life insurers

Uncovered

Nov 29th 2001 | TOKYO
From The Economist print edition

From bad to worse

CAN anybody save Japan's life insurers? In the past couple of years, five have gone bust, and the rest have all got a lot weaker. For years they have guaranteed rates of return above what they can earn in an era of low interest rates. On November 28th, the seven biggest warned that this problem could lose them more than ¥1.2 trillion ($9.7 billion) in the year to March 2002. Falling stockmarkets do not help insurers' equity portfolios either. And worst of all, every piece of bad news these days triggers fresh policy cancellations.

Weak firms are attempting to stem the outflow by linking up with bigger partners. Last week Mitsui Mutual, the weakest of the seven, joined in an alliance with Sumitomo Mitsui Bank, Sumitomo Life and Mitsui Sumitomo Insurance, a non-life insurer. The move was intended, at least in part, to boost consumers' confidence in Mitsui Mutual. In the six months to September, policy cancellations at Mitsui rose by 23%; and new policies were down by 15% on a year earlier. It is not clear how effective the move will be, though: Sumitomo Mitsui Bank has massive bad debts of its own and has yet to commit fresh funds to Mitsui.

Asahi Mutual, another shaky life insurer, has teamed up with Tokio Marine & Fire, the largest property and casualty insurer. Using a tactic first tried by GE Capital when it tied up with Toho Mutual (which later collapsed), Tokio plans to “ring-fence” Asahi's liabilities—by buying only its new business operations next March and folding them into its own life-insurance subsidiary. Asahi hopes that the extra cash will boost its finances and allow it to restructure its remaining operations. If Asahi shapes up, it just might merge with Tokio Marine & Fire in 2003.

Others hope that Tokio will ride to the rescue either way. Asahi has traditionally close ties to Dai-ichi Kangyo Bank (DKB), one of the trio that makes up Mizuho, the country's biggest banking group. DKB is thought to have lent more than ¥100 billion (including subordinated debt) to Asahi; if those loans turned sour, it would be a big blow for the whole Mizuho group, which is itself weak. Asahi faces an uphill task turning its business around after it loses its new-business operations. Yet Tokio, whose own credit outlook has been downgraded by Moody's, is unlikely to merge with a sickly partner if that further threatens its own financial stability.

The life-insurance industry suffered some nasty jolts when the capital deficits (ie, shortfalls) of some bankrupt insurers rose sharply after their assets were revalued or sold (see table). By forming alliances, potential merger partners can keep an eye on their counterparts and perhaps stop them from making wild bets (say, on currencies) to save their businesses.

This sort of damage control may be all that an industry running out of time and solutions can hope for. Earlier this year, the government considered allowing life insurers to cut their pay-outs, at the expense of policyholders. Discussions stalled, merely highlighting the distress.

Instead of trying to bail them out, the government ought to be helping to boost insurers' credibility by improving their poor standards of disclosure. It could start by revising outdated regulations that led Nippon Life, the biggest life insurer, to be penalised by the Financial Services Agency (FSA) in November for distributing marketing documents that listed the solvency margins (FSA-approved ratios that measure capital adequacy) of the top

seven life insurers, highlighting the two lowest. Life insurers are not allowed overtly to compare their financial strength with their rivals' in order to sell policies.

That was fine, maybe, in the days when Japan's financial authorities could guarantee that no bank or life insurer would ever go bust. Times have changed, however. Bewildered policyholders have been told to take more responsibility for their investment decisions, yet they have to turn to tabloid publications to find out which insurers are most risky. Even members of the government's committee on deregulation, among many others, are now arguing that insurers should be allowed to advertise their own strengths, and also their rivals' weaknesses.

Skeletons

Capital deficits at bankrupt Japanese life insurers
¥bn

	Reported deficit at time of collapse	Final deficit	Date of collapse
Toho Mutual	199	650	Jun 1999
Daihyaku Mutual	45	320	May 2000
Taisho Life	1	37	Aug 2000
Chiyoda Mutual	34	598	Oct 2000
Kyoei Life	5	690	Oct 2000
Tokyo Mutual	34	73	Mar 2001

Source: Financial Services Agency

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About sponsorship

Monetary policy

Europe's money puzzle

Nov 29th 2001 | FRANKFURT
From The Economist print edition

The ECB is pragmatic, after all

THE European Central Bank has long said that its figures for growth of M3, its favoured measure of money supply, are incorrect: distorted, it says, by short-term euro-denominated debt held by investors outside the euro area. On November 28th it published cleansed figures: M3 grew by 7.4% in the year to October, 0.6 percentage points less than under the distorted measure.

This matters, because the money supply is the first of the ECB's two monetary-policy “pillars”. When the bank ironed another wrinkle out of its data in May, it used the correction to justify a quarter-point cut in interest rates. The second pillar includes everything else that might affect inflation—demand, commodity prices, wages and so forth.

Revised M3 growth rate is still far above the ECB's “reference value” (not, it insists, a target) of 4.5%, and it is rising fast. So why isn't the ECB raising rates instead of cutting them? When M3 growth took off earlier this year, the bank put it down to a portfolio switch from equities to cash: this was not spending money, it said, therefore there was no inflationary danger. Fine, but in October stockmarkets rallied. Ah, says the bank, there is still “high uncertainty in financial markets”, and credit growth is declining.

Fair enough, but does money deserve its own pillar? This year, the ECB has been cutting rates because demand is weak, oil prices have fallen and labour markets are slacker. Money has been lightly explained away, May's bizarre episode aside. In other words, the ECB has been behaving much like any other sensible central bank: it follows money closely, but not slavishly. Time to bring presentation into line with practice, and knock money off its pedestal?

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Europe's economies

Wheezing

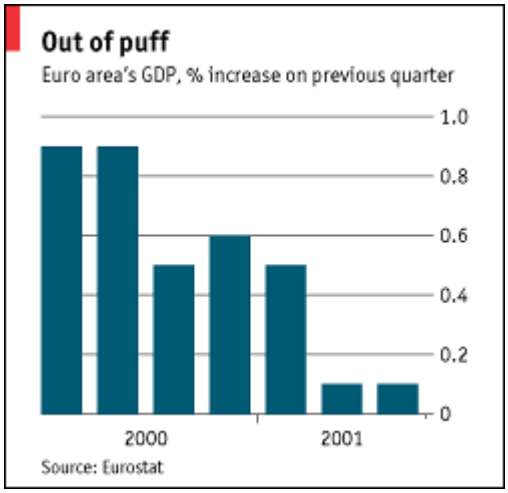
Nov 29th 2001 | FRANKFURT
From The Economist print edition

EPA

The euro-area economy is probably shrinking. Recovery will be slow

ALLEZ France! Almost single-handed, French consumers, who in the third quarter of this year spent an annualised 5% more than in the previous three months, kept the euro area's economy afloat. Among the three largest economies, which account for 70% of euro-area GDP, only France looked healthy, growing by 0.5%. Italy managed just 0.2%; Germany's economy, poorly for a year, actually shrank. As a whole, the euro area grew by a mere 0.1% (see chart).

Do not expect the French to keep it up, though. Consumption fell by 0.4% in October, and rising unemployment will probably keep spending in check. Nor is anybody else likely to take up the running. The European Commission reckons that, of the ten euro-area economies for which it forecasts quarterly GDP, only Spain and Finland will grow by more than 0.25% in the fourth quarter. The odd two out, Greece and Luxembourg, may well do better, but all four together make up less than one-seventh of the euro area's GDP.



The three biggest economies, and with them the euro area as a whole, are probably now shrinking, along with America and Japan. Whether the euro area's contraction will last for more than one quarter is unclear. Yet even optimists expect only slow growth in early 2002.

The best hope for revival lies in a reversal of the forces that have aggravated the euro area's slowdown. Rising prices, first of oil and then of food, ate into real incomes and depressed spending. The prices of oil and other commodities have since fallen fast, and the effects of foot-and-mouth disease and BSE are due to drop out of the inflation figures. Some economists think that inflation, now 2.4%, will fall to 1% or less in 2002. As well as boosting real incomes, falling inflation (or the expectation of it) ought to create more room for the European Central Bank (ECB) to cut interest rates below today's 3.25%.

In both France and Germany, inventories were run down in the third quarter, so there is not much more destocking to be done. Germany's construction industry, in decline for two years and a huge drag on growth at the start of 2001, almost stopped shrinking in the third quarter. The euro's weakness against the dollar and the yen should help exports.

That's the good news. Much else is amiss, notably America's slide into recession. This has hurt exports,

but it has not reduced the euro area's trade surplus, since imports have been squeezed just as hard. Indeed, says Dieter Wermuth of Tokai Bank in Frankfurt, Germany is seeing a “trade miracle”: exports actually rose in the third quarter, while imports fell. The trade balance had a big positive effect on Germany's GDP figure; feeble domestic demand clobbered the total.

America's recession is feeding through to GDP in other ways. Weakening exports are knocking domestic demand, through lower orders to suppliers and cuts in investment. Second, European companies have become more exposed to America through foreign direct investment: the American affiliates of European multinationals doubled their sales in the 1990s, which are now equivalent to almost 9% of euro-area GDP. An American slowdown means less profit, less investment and lower employment—in Europe as well as in the United States.

Third, America's troubles are sapping Europe's confidence. That has been much clearer since September 11th: Germany's Ifo index of business confidence dipped again in October, after plummeting in September. The link between spirits in the two big economic regions is more than a couple of months old. The European Commission says that, between 1995 and 2001, the correlation between confidence indices in the euro area and America has been almost 0.9, with America just eight or nine months ahead. Where American businesses and consumers lead, Europeans seem to follow closely behind.

On top of this, there are domestic weaknesses to worry about. Unemployment, which kept falling in the early stages of the downturn, is now expected to rise. The ECB has so far been slow to cut interest rates, and may remain slow in future. The scope for loosening fiscal policy, especially in Germany, is small: next year's deficit will probably be close to the limits set by the euro area's stability and growth pact, which Germany's finance minister is determined not to violate. Salvation in an American recovery, then? Not only. If rising inflation dragged Europe down, falling inflation should help pull it up. With luck, the fourth quarter will be as bad as it gets for the old continent. But don't bet on it; and expect a slow climb back up.

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Russian finance

Bang on time

Nov 29th 2001 | MOSCOW
From The Economist print edition

What's this? Russia redeeming its debts?

WHAT a happy coincidence: just as falling oil prices start putting Russia into a financial squeeze, the country returns to respectability. One big reason is the chance that September 11th has given Russia to polish its image.

In the financial markets, spreads of Russian bonds denominated in dollars have fallen by two percentage points—potentially a huge saving, if the country now chooses to refinance part of its $138 billion of foreign debt. The relatively blissful economic conditions of the past two years (a high oil price and the benefits that can be banked from a huge devaluation) mean that Russia has been treating its main creditors properly of late.

This week it paid back a $1 billion eurobond to some cheery, and shrewd, investors. Its price had quadrupled since the Russian financial crisis of 1998 (see chart), when the country defaulted on large chunks of its debt. In fact, sovereign eurobonds have always been a pretty good bet. After the collapse of the Soviet Union, Russia honoured the evil empire's eurobonds even as it was reneging on other debts. Russia has never missed an interest payment on its own eurobonds, in sharp contrast to its treatment of other obligations. Even so, the sight of any Russian debt being paid back in full and on time is rare, and encouraging. It will no doubt ease Russian borrowers' return to the international markets in the coming months.

Another encouragement is that Russia is about to go back into the black at the International Monetary Fund. After an early repayment of $1.7 billion in October, it needs to repay only $700m more in order to have a debt smaller than its outstanding quota at the Fund.

The question now is whether Russia will again try to reschedule its $39 billion of Paris Club debt to western governments, of which $4 billion falls due next year. So far Germany, the biggest creditor, has argued strongly that Russia's bulging central-bank reserves ($38 billion) and current-account surplus ($39 billion, or 12% of GDP) mean that there is no case for a restructuring; and President Vladimir Putin has said that Russia will not seek one. That may change, though, if the oil price dives deeper.

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Tax havens in the West Indies

Top flight

Nov 29th 2001 | PORT OF SPAIN, TRINIDAD
From The Economist print edition

The will, as much as the law, is needed against financial crime

ABOVE the court house in Kingstown, St Vincent's 21-member parliament met to debate a money-laundering bill on November 21st. Why, asked the leader of the opposition, Arnhim Eustace, had the United States tried a week before to have Thierry Nano, one of the island's leading offshore bankers, held for extradition on money-laundering charges? And why was Mr Nano allowed to leave the country on November 18th, chartering a small plane to the French overseas department of Martinique? Was the government really serious about reform?

Along with neighbouring Dominica, Grenada and St Kitts-Nevis, St Vincent has been listed by the OECD's Financial Action Task Force (FATF) in Paris as a “non co-operative jurisdiction” when it comes to money laundering and financial crime. All four are trying to reform, with plenty of outside help.

The Nano family, Thierry and his father Armando, set up their first offshore bank in the 1970s, when St Vincent was still an “associated state” with Britain. They claim a long family history in banking, first in medieval Genoa, then in modern France. Citizens of St Vincent since 1988, the Nanos prospered. Laws passed in 1996, when Mr Eustace's New Democratic Party (NDP) was in office, appeared to give them near-total secrecy.

Then the tide turned. Under outside pressure, St Vincent started to tighten its banking rules. Not fast enough for the FATF, which blacklisted the island in June 2000. The government quickly withdrew the Nano family's banking licences. The family fought back through the courts. They also accused the prime minister, his cabinet colleagues and the police chief of borrowing from their banks and failing to pay back the loans.

In March 2001, the Unity Labour Party swept the NDP from power and pledged reform. A newly appointed “offshore finance inspector”—once part of the Nanos' legal team—was persuaded that there were no legal grounds for withholding the family's banking licences. His board agreed.

The government holds that Vincentian citizens cannot legally be extradited for money laundering—or at least, they could not until the law was reformed last week. Mr Eustace says existing laws and treaties already allow extradition, including to the United States. Still, nobody in St Vincent seems terribly clear about the details. Documents like these “are signed for certain reasons at certain times,” says a senior official, “then they just get tucked away.”

Dominica, too, has had its embarrassments. On November 17th, a former vice-president of the governing Dominica Labour Party, Julian Giraud, was arrested on money-laundering charges in Puerto Rico, en route from his home island to Miami. Travelling with him was his country's finance minister, Ambrose George. Mr George says he and Mr Giraud were on a mission to “obtain the necessary resources to meet the needs of our people, through contacts with foreign investors and financiers.” The trip was paid for by a “third party”. Mr George told his prime minister that he was travelling, but did not state the purpose of his trip. He knew of “adverse comments” about Mr Giraud, not of crime or dishonesty.

A team from the FATF visits the blacklisted Caribbean islands in December. They will be told about legal reforms, staff training and new financial-investigation units. The islands say that they cannot survive on bananas and tourism, and that they are victimised for competing too effectively with bigger financial centres. To succeed, they probably know now that simply passing laws against financial crime is no longer enough.

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Economics focus

Say “R”

Nov 29th 2001
From The Economist print edition

Economists have a dismal record in predicting recession

AS RECENTLY as February, 95% of American economists said it wouldn't happen, but it has. America is now in recession, according to—don't laugh—the Business Cycle Dating Committee at the National Bureau of Economic Research (NBER), the official arbiter of American business cycles. This group of six economists reckons that the recession began in March, after ten years of expansion, the longest in American history.

To followers of *The Economist*'s R-word index (which counts the number of times that the word “recession” appears in American newspapers), this comes as no surprise. The index, unrigorous as it is, has accurately pinpointed the start of previous recessions, and it started to flash red in the first quarter of this year. But most American economists thought otherwise. Last January *The Economist*'s poll of forecasters predicted, on average, that GDP growth would be 2.3% in 2001. Now the country will be lucky if it sees growth of 1%. Even in early September few economists were forecasting a recession. Now it appears that one had already been under way for almost six months.

How should you define recession? The most popular rule of thumb is that it means two consecutive quarters of declining GDP, and so far America has seen only one quarter's decline. But the NBER committee rejects this criterion as neither necessary nor sufficient.

It is possible to have a recession without two consecutive quarterly contractions, as America and others have had. GDP could fall sharply in one quarter, for example, rise slightly in the next quarter, and then plunge again in a third. That certainly ought to count as a recession. On the other hand, if output fell only slightly in each of two consecutive quarters, that might not be enough to warrant the label. Most newspapers were quick last week to declare the German economy in recession after German GDP fell by 0.03% in the second quarter and by 0.1% in the third. That would probably not pass the NBER recession test.

The NBER committee defines recession as a significant decline in activity, spread across the economy and lasting more than a few months, and also visible in industrial production, employment, real income, and business and retail sales. The declared starting-point of a recession is then based on a compromise between the different times at which all these indicators start turning down.

How long they last
Duration and depth of US recessions

Recession dates	Duration in months	% fall in GDP, peak to trough
1948-49	11	3.6
1953-54	10	2.6
1957-58	8	3.2
1960-61	10	0.5
1969-70	11	0.1
1973-75	16	3.4
1980	6	2.2
1981-82	16	2.8
1990-91	8	1.3

Sources: NBER; Thomson Financial Datastream

The committee does not pay much attention to GDP figures themselves, since these are published only quarterly and are subject to large revisions. The first estimate of GDP for the third quarter of 1990, the official start of the previous recession, showed that the economy was still growing. It was later revised down to reveal that the economy had already started to contract. There is a good chance that America's slim reported growth in the second quarter of this year will also be revised away.

It does not help that “recession” means different things in different countries. Conventionally, it is seen as a fall in output, yet that is too crude. For instance, very low GDP growth in an economy with rapid population growth implies falling GDP per head. Likewise, low growth that is below trend in an economy with a high trend rate of growth (perhaps because of a fast-growing labour force or high productivity growth) will feel like a recession and will cause unemployment to rise.

This problem is particularly acute in emerging economies. For instance, South Korea's GDP has risen by 1.8% over the past year. By European standards, that sounds fairly respectable, but compared with South Korea's average annual growth of 6% over the past ten years, it should be counted as a recession. A more sensible definition of recession might be when growth falls significantly below its long-term potential, causing unemployment to rise. In practice, potential growth rates are hard to estimate.

Depth gauge

Why are recessions so hard to forecast? A study published last year by the International Monetary Fund looked at the economists' record. It is bad. Of 60 recessions in developed and developing economies during the 1990s, two-thirds remained undetected by consensus forecasts as late as April of the year in which the recessions occurred. In one-quarter of cases, the consensus forecast in October of that year still expected positive growth.

Are economists any better at predicting when recessions will end? Most now forecast that America will start to recover early next year, following one of the mildest recessions in its history. The consensus forecast is for a peak-to-trough decline of just over 1%, compared with an average decline during recessions in the past half-century of over 2%.

The average recession since the second world war has lasted for 11 months, which suggests that the recession might be over by next February. On the other hand, between 1854 and 1945 the average recession lasted for 21 months. The present economic cycle may have more in common with those before the second world war than with those after. In particular, this recession, unlike earlier post-war recessions, was not caused by America's Federal Reserve raising interest rates sharply in response to a burst of inflation. Rather, a financial bubble popped and an investment boom turned to bust. Such recessions, with the deflationary forces they generate, tend to be more prolonged—witness Britain in the early 1990s and Japan today.

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Global fish stocks

Fishy figures

Nov 29th 2001
From The Economist print edition

The world's fish catch may be much smaller than previously thought

Get article background

FISHERY statistics tend, just like fish, to be rather slippery. Lying by individuals, industries and countries is expected by the body that has collated global fishery statistics for the past half-century. But the Food and Agriculture Organisation (FAO) had assumed that, unless everybody lied at the same time and in the same direction, discrepancies in the global figures would pretty much cancel each other out.

Unfortunately, this approach overlooked the possibility that a single large contributor might be lying spectacularly. And according to Reg Watson and Daniel Pauly, two researchers at the University of British Columbia in Vancouver, that is what China has been doing for at least ten years. This, they say, has masked a big downward trend in the global fish catch.

Their research was prompted by the observation that local fisheries around the world were collapsing, yet the global catch, which was expected to plateau in the 1990s at around 80m tonnes per year, was slowly increasing. Taking the FAO's fish-catch statistics since the 1950s, the researchers worked out the relationship between catch and various oceanographic and environmental factors, such as depth of the ocean, latitude, ice cover, surface temperature and distance from the shore.

How can local fisheries worldwide be collapsing as the global catch "increases"?

After verifying that their model was able to predict the location of most high-catch regions of the world, they went on to create a global map of the difference between expected (or modelled) catches, and officially reported statistics. This revealed a shocking discrepancy. In China, a catch of 5.5m tonnes was expected in 1999; but the official figure was 10.1m tonnes.

When the pair replaced official statistics with estimates, the global catch showed a wobbly downward trend, shrinking by some 360,000 tonnes every year since 1988. And when they removed the catches of a single, highly fluctuating species, the Peruvian anchoveta, the data revealed a strong and consistent downturn, of 660,000 tonnes a year. In other words, contrary to official figures suggesting that the marine catch has been slowly growing for the past few years, it has in fact been in decline.

That the Chinese figures are unreliable is hardly surprising, since until recently Chinese officials were promoted on the basis of production increases. What is surprising is that such a distortion of global statistics might be possible. The FAO offers several defences. One is that these new findings, published in this week's *Nature*, are based on modelling, which does not prove anything. The suggestion that China

might be cooking the books is not new. The FAO says it has been suspicious of the Chinese figures for the past six years.

Richard Grainger, the FAO's chief statistician, argues that global figures are not important, because fisheries are managed at a regional level. This means that any inaccuracies in the Chinese figures would affect only China and not perceptions of the state of other world fisheries. Because China is not a great importer or exporter of fish, the food-security implications are limited to the region. Anyway, he says, few people look at global figures without reference to regional trends.

Not so many fish in the sea

Andy Rosenberg, a fisheries scientist at the University of New Hampshire, disagrees. He says that graphs showing a stable global catch are often shown at international meetings, not least by the FAO. Indeed, on the first page of the FAO's most recent annual report, the global fish catch is described as remaining “relatively stable”.

Dr Rosenberg also says that many countries assume that, as long as the overall picture remains healthy, fisheries management is a problem for the long term. As long as global volumes are rising or stable, it seems reasonable to conclude that the exhaustion of local fishing grounds has been balanced by the opening of new grounds farther afield. The new research suggests that this is wrong.

If the global catch is declining, despite the unprecedented effort being made to maintain production, stocks must be in decline too. What can be done? Some look to fish farming, or aquaculture, as a way of maintaining production. In the short term, this may work. But most farmed fish are fed a diet consisting mainly of fish taken out of the ocean. So although aquaculture may boost edible fish production, it is ultimately limited by marine fish resources.

One novel approach attempts to bring consumer pressure to bear. Unilever, the world's largest buyer of frozen seafood, set up the Marine Stewardship Council (MSC), in conjunction with the World Wildlife Fund, in 1998. The MSC sets environmental standards for sustainable and well-managed fisheries and awards a quality mark to those that make the grade. Unilever says it will buy all its fish from sustainable fisheries by 2005.

Many other options have been proposed to deal with the problem of overfishing, such as reducing the capacity of fishing fleets, setting up marine reserves, removing government subsidies or assigning property rights to individuals or groups of fishermen to provide an incentive for good stock-management practices. The problem with this latter approach is that it requires elaborate and expensive policing. And if stocks are stable, as the FAO's figures suggest, why bother?

As with global warming, governments will take action only when the urgency of the situation has become fully apparent. By pointing out that a stable supply of marine fish can no longer be taken for granted, Dr Watson and Dr Pauly have raised an important alarm.

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AIDS

Unhappy anniversary

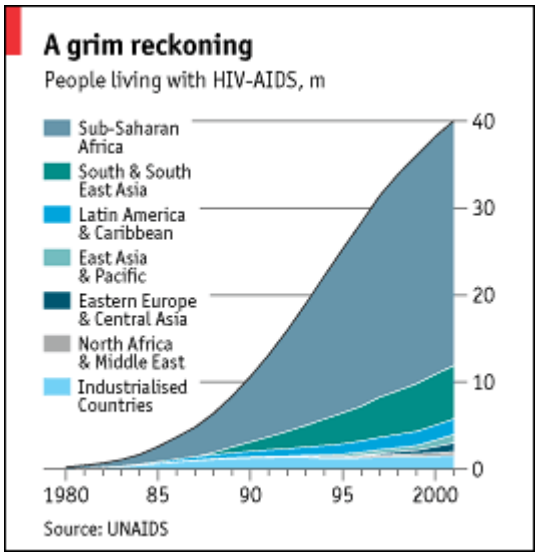
Nov 29th 2001
From The Economist print edition

Twenty years on, the fight against AIDS is not going well

Get article background

IT IS 20 years since clinical reports of a new and deadly immunological disorder, now known as AIDS, first surfaced. Since then the disease has become a household word and unfortunately, an all-too-common household affliction. In 1980, there were around 225,000 people infected with HIV, the virus that causes AIDS. By 2001, that number had spiralled to 40m, according to the AIDS Epidemic Update published this week by UNAIDS and the World Health Organisation (see chart). This year alone, roughly 5m people have joined the ranks of the infected, and 3m have died of AIDS.

Almost 70% of new infections and existing cases—a daunting 28.1m people—are in sub-Saharan Africa. AIDS is now cutting 15 years off average life expectancy in the region; according to some estimates it will slice 8% off national incomes in the worst-afflicted countries by 2010. Although a few countries, such as Uganda, are coming to grips with the disease through education, condom distribution and other preventive measures, lack of money and political will is thwarting efforts elsewhere.



But Africa is not alone in its suffering. Eastern Europe now has the world's fastest-growing AIDS epidemic, with 250,000 new cases in 2001. Hardest-hit are Russia and Ukraine, where unemployment and changing social norms are leading to an explosion of risky intravenous drug use, and health-care services are disintegrating. UNAIDS is also worried about the rise in HIV cases in China, due to exceed 1m this year, and about a resurgence of infections in North America and Western Europe, particularly among homosexual men.

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Cloning

Storm in a test tube

Nov 29th 2001
From The Economist print edition

How significant is the creation of the first cloned human embryo?

Get article background

IN THE four years since a sheep called Dolly—the world's first cloned mammal—made her public debut, scientists, politicians and ethicists have been wringing their hands over the prospect that it will soon be possible to clone humans, too. The debate centres on two types of cloning: reproductive, with a view to producing a baby, and therapeutic, with the aim of creating a source of "embryonic" stem cells that might replace dysfunctional bits of the body in Parkinson's disease and other degenerative conditions.

Don't place your order just yet

Cloning has both strong supporters and fierce critics. Despite the deeply held moral and technological objections of many people, human cloning took a small step forward this week with an announcement by researchers at Advanced Cell Technology (ACT), a private American biotechnology firm, that they had successfully created a human embryo through cloning, for the purpose of developing stem cells. They are not the first to lay claim to such a feat, but they are the first to publish their findings, which appeared online in *E-biomed: The Journal of Regenerative Medicine*. Their work was promptly condemned by President George Bush, who said it was morally wrong, and by the Vatican, among many others.

From a technical standpoint, such vehement condemnation seems out of line with the slender scientific significance of this development. ACT used what has become a standard cloning method in animals. This is to remove the nucleus containing genetic material from a donor egg, and replace it with the nucleus of another cell, so providing the reconstructed egg with a full complement of genes. The idea behind therapeutic cloning is that the donor nucleus might come from a patient's own cells. The resulting stem cells would then be genetically identical to the donor, avoiding problems of rejection when they are returned to the patient in treatment.

The researchers used nuclei from two sorts of cells: skin cells and cumulus cells, which are found in a woman's ovaries. These were inserted into a total of 19 eggs. The 11 eggs with skin-cell nuclei failed to develop. So did most of those with cumulus-cell nuclei; only three showed signs of progress, dividing to produce, at most, a bundle of six new cells.

According to Alan Colman, a cloning expert at PPL Therapeutics, a British biotechnology company, this is a far cry from something useful. Embryos used for implantation in human *in vitro* fertilisation, or for stem-cell production in the one species where cloning has worked for such a purpose—namely mice—consist of 60-100 cells. These embryos are far more developed than those created by ACT. This shows just how hard human cloning will be, even in the hands of professionals, let alone amateurs such as Severino Antinori, an Italian fertility doctor, or the Raelians, a fringe cult whose cloning plans have excited universal outrage.

Nonetheless, the new research suggests that governments need to move faster to regulate this

controversial technology. Public opinion in America and Europe is strongly opposed to reproductive cloning, yet few countries have the right legislation to control it. In America, a bill outlawing reproductive cloning has been stuck in Congress for months. In Britain, new legislation is now going through Parliament after a recent adverse court decision (the bill passed the House of Lords this week).

It is still too early to tell whether therapeutic cloning will live up to its expectations as a commercial source of stem cells. But even if it does not, therapeutic cloning may provide useful scientific information about cloned embryo development, which might come in handy should aversion to reproductive cloning diminish some day.

For the moment, fears that therapeutic cloning will inevitably lead to reproductive cloning can be dealt with through better regulation. This means more than merely denying federal research funds to therapeutic cloners, as happens in America, since recent events clearly show that this has little effect on the private sector.

Better regulation should assuage fears that theraputic cloning will inevitably lead to reproductive cloning

A more logical approach would be to create a federal regulatory body to cover human infertility, from *in vitro* fertilisation centres to embryo research. This agency could then be empowered to issue licences for “approved” activities in both the public and private sector, and to impose stiff penalties on offenders. In America, this would have the salutary effect of reining in fertility clinics plagued by a recent spate of scandals, and setting standards for those in the business of therapeutic cloning, including mandatory disposal of embryos within two weeks of creation.

Britain already has such a body, called the Human Fertilisation and Embryology Authority (HFEA); but it has recently found itself hampered by bad legislation. Despite earlier government efforts to expand its remit, a successful court challenge by pro-life advocates has meant that the authority does not, in fact, have a say over what happens to cloned embryos. This means that, until a new law is passed, or the court ruling overturned, therapeutic cloning is, in effect, unregulated.

John Harris, an ethicist at the Univeristy of Manchester, reckons that a better approach than today's piecemeal legislation would be a broad bill giving the authority control over embryos of any kind and over all forms of cloning. This would allow it to license the therapeutic variety but impose a moratorium on the reproductive kind until further notice. Human cloning is still a distant prospect; with luck, sensible regulations are closer to hand.

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Extrasolar planets

Atmospheric stuff

Nov 29th 2001
From The Economist print edition

Astronomers are probing the composition of a planet around another star

ON JUNE 6th 1761, a small black dot drifted across the face of the sun. It was Venus, making a rare passage directly between the sun and earth. Mikhail Lomonosov, a Russian scientist, watched this event through a telescope, and noticed that the edge of Venus's shadow was not sharp—it was a bit fuzzy, as if the planet were enveloped by a thin haze. He was the first person to discover the atmosphere of another planet.

Astronomers have now repeated Lomonosov's feat. But the planet is not Venus. It is not even in our solar system. On November 27th, a team of astronomers announced that they had detected the atmosphere of a planet 150 light-years away. This accomplishment is a milestone in the study of “extrasolar” planets—those that orbit other stars.

Around 80 such planets have been discovered in recent years. Until now, almost all that was known about each one was its approximate mass and its distance from its parent star, both of which can be inferred from the back-and-forth wobbling of the star caused by the gravitational pull of the orbiting planet. The one exception is the planet going around a star called, rather prosaically, HD 209458. This planet's orbit is a circle that happens to be oriented almost exactly edge-on when viewed from the earth. As a result, every 3.5 days the planet moves directly in front of the star, just as Venus occasionally moves in front of the sun.

The star is much too far off for any telescope to make out a tiny black dot crossing its face. But when the planet moves in front of it, it blocks some of the starlight, and this dimming is easily observed. The amount of dimming depends on the planet's cross-section. This has allowed astronomers to determine the size of the planet: it is a gas giant like Jupiter, but 35% bigger.

The first group of astronomers to do this was led by David Charbonneau, of the California Institute of Technology, and Timothy Brown, of the National Centre for Atmospheric Research in Boulder, Colorado. They have now performed an extrasolar version of Lomonosov's trick to measure the chemical composition of the planet's atmosphere. Their results will appear soon in the *Astrophysical Journal*.

The astronomers used a spectrograph aboard the *Hubble* space telescope to dissect the starlight from HD 209458, both before and after the planet moved in front of it. When the planet was in front of the star, one particular colour of the starlight was slightly fainter than the rest: the orange-yellow hue that is absorbed by sodium and is emitted by the sodium lamps that light motorways. Light of this colour was, the astronomers deduced, being absorbed by sodium in the planet's atmosphere.

The discovery of sodium itself is not surprising—all the big planets in our solar system contain it. What surprised Dr Charbonneau and Dr Brown is that the amount of sodium was lower than they and other scientists had predicted. This may be due to clouds high in the planet's atmosphere. Because clouds are opaque to all colours of light, their presence reduces the contrast between the orange-yellow hue of sodium and the other colours.

What has made extrasolar astronomers jubilant is not this particular discovery, but the demonstration that the chemical make-up of distant planets can be studied using present-day telescopes. Sodium happens to be one of the easiest substances to detect using this technique (which is why Dr Charbonneau and Dr Brown decided to look for it), but astronomers will now be looking hard for helium, methane, water and other substances that might tell them what extrasolar planets are made of and what their weather is like.

The real news is that the chemical make-up of distant planets can be studied

using present-day telescopes

In the longer term, a spectrograph may be the best way to detect signs of life on other planets. For example, detecting lots of oxygen in a planet's atmosphere would be exciting. Oxygen reacts readily with other elements, so it should not be present in pure form unless it is being constantly replenished—as it is by plants on earth.

Unfortunately, all of the planets that have been discovered so far are probably giant balls of gas, like Jupiter, rather than hospitable lumps of rock like the earth. Many of them are also very close to their parent stars, making them uncomfortably hot. Finding earth-like planets, and studying them with a spectrograph, will require purpose-built space telescopes, several of which are now on the drawing board. Looking for alien life is an appealing goal, but a tremendously challenging one. For now, astronomers are content to have found a little sodium.

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Garden flowers in history

Florabundant

Nov 29th 2001
From The Economist print edition

Fashion, not nature, rules the garden flowerbed

Flora: An Illustrated History of the Garden Flower
By Brent Elliott

Firefly Books; 336 pages; $60.
Scriptum-Cartago, in association with the Royal Horticultural Society; £45

Buy it at
Amazon.com
Amazon.co.uk
Amazon.com
Amazon.co.uk

WHEN the first Spaniards arrived in Mexico in the early 16th century, they found that the Aztecs had created what were to all intents and purposes botanic gardens, where trees and flowers were laid out methodically according to their appearance and medicinal use. They contained plants that were quite unfamiliar to the conquerors: aloes and other oddly shaped succulents, sunflowers, marigolds, lobelias and the intriguing passion flower. News of these and other phenomena was conveyed home in a book by Nicolas Monardes, translated into English in 1577 under the title “Joyfull Newes out of the Newe Founde Worlde”.

Very soon the conquerors were bringing back not just the joyful news, but the seeds and roots of the new-found plants themselves. The spread of Europe's first botanical gardens quickly followed. It became apparent that plants from distant lands were not simply scientific curiosities, but had the power to inspire enthusiasms so extreme they could develop into obsessions. The outbreak of tulipomania that afflicted the Netherlands in the 17th century is the best known but by no means the only occasion when the perceived perfection of a species seduced its devotees into irrational behaviour.

Among the many flowers that have from time to time inspired cultlike followings are the hyacinth and the ranunculus (both, like the tulip, originating in Turkey), the dahlia from Central America, the pelargonium from South Africa, the aspidistra from China and the clematis from Japan. In 1849 gardeners at the Royal Botanic Gardens at Kew and the Duke of Devonshire's estate at Chatsworth staged a well publicised contest to cultivate the first flowering specimen in England of the newly-discovered giant Amazonian water lily, *Victoria amazonica*. The duke won because his head gardener, Joseph Paxton, was able to build an oversized glasshouse specifically to accommodate it, using skills that he would soon employ to design the Crystal Palace for the Great Exhibition of 1851.

Not all the plant introductions from overseas had a benign long-term effect on global horticulture. *Rhododendron ponticum*, brought to Britain from the Caucasus in 1763, is now so rampant that in some parts of the country it is treated as a weed. And Japanese knotweed, eagerly brought west in the 19th century to provide ornamental foliage, is now rampaging uncontrollably over gardens in Europe and North America, sometimes escaping into the streets and pushing through cracks in walls and pavements.

Even when they have no such drawbacks, plants and flowers fall in and out of fashion through changes in popular taste. One of the many strengths of this book is the clarity and care with which the author chronicles the ups and downs of horticultural reputations, from a newcomer's first ecstatic welcome into the floral garden until it sinks to the more obscure pages of the seed and bulb catalogues, or sometimes disappears altogether.

Eventually the pendulum swings back and great prestige is to be gained through rediscovering and reintroducing forgotten flowers. Striped carnations were all the rage in many countries during the 18th and 19th centuries, only to fade from view in the 20th. Petunias and verbenas were the plants of choice

for English garden bedding until the 1860s when, as a contemporary writer recorded, they were “nearly all swept away” by pelargonium hybrids. Australian natives, notably the banksia, were keenly taken up in Europe as greenhouse subjects at the end of the 18th century, abruptly dropped after about 60 years and are suddenly in vogue again. The introduction of carpet bedding into British public parks in the 1870s led to a demand for small foliage plants and flowers such as begonias. Although they fell out of favour when the beds proved too costly to maintain after the second world war, today they are back in style. Old-fashioned roses went out when hybrid teas came in, but are now highly prized.

Mr Elliott is the librarian and archivist of the Royal Horticultural Society in London, and thus has at his disposal an unrivalled collection of historic and beguiling flower prints. He makes marvellous use of them in this exceptionally handsome volume. The life story of each plant is told in terse chunks of text that amount to a great deal more than extended captions, making this a fascinating work of reference as well as a joy to behold.

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Smallpox in history

Spot searches

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SMALLPOX, like anthrax, begins as flu—a headache, sore joints, a slight fever that quickly abates. Relief is fleeting, though. Over 24 hours the disease either turns inward, causing subcutaneous haemorrhaging, or outward, covering you in pustules that concentrate in precisely the places where they will cause the greatest anguish and pain, the soles of the feet, the face and the palms of your hands. If the pustules do not run together, the prognosis is good. But if they converge in a single oozing mass, known as confluent smallpox, there is a high chance you will die. If you don't, the good news is that the immunity created by the disease means you will never catch smallpox again.

Smallpox has been known to man since the Pharaohs. Traders carried it from Egypt to India, where Sanskrit medical texts describe epidemics as far back as 1500BC, Jonathan Tucker explains in “Scourge”. According to Thucydides, it killed a third of the population of Athens in 430BC. Alexander the Great's army was ravaged by the disease as were the Abyssinian troops on elephants that besieged Mecca in 570AD, an incident described in the Koran.

Scourge: The Once and Future Smallpox
By Jonathan B. Tucker

Atlantic Monthly Press; $26

Buy it at
Amazon.com

Pox Americana: The Great Smallpox Epidemic of 1775-82
By Elizabeth A. Fenn

Hill and Wang; $25

Buy it at
Amazon.com
Amazon.co.uk

Mr Tucker, who has worked for the State Department and the Arms Control and Disarmament Agency, traces the disease's historic arc. He pauses briefly on its supposed eradication in 1978, but his real interest is in exploring the possibility that secret laboratory stocks of smallpox may still exist and, worse, that they could easily be put to use by unscrupulous regimes. His speculations feed into the current bioterrorism frenzy, but nonetheless they remain just that, speculations.

Most histories have dealt with the American smallpox outbreak of 1775 as a footnote to the real business of the revolutionary war that was beginning to transform the 13 British colonies in America into a new nation. Elizabeth Fenn, a historian at George Washington University, has made fresh use of many primary sources, particularly the burial records kept by the Catholic parishes across Spanish North America, to put together a remarkable portrait of an epidemic that killed five times more people on the entire continent than the war of independence did in the east.

The pox really took hold during the 11-month siege of Boston following the battles of Lexington and Concord in April 1775. Americans had been less exposed to smallpox than Europeans, and were thus more vulnerable to the disease. The crowded city, with its dirty housing and inadequate food supplies, helped the virus proliferate. In their ignorance, the authorities forbad inoculation, though soldiers inoculated themselves in secret, rubbing infected clothing into scratches in their thighs at night in the belief that in this way they would escape detection.

At the same time, smallpox broke out in Quebec where each new volunteer soldier turned into a potential fresh host for the virus and a headache, once he became ill, for the authorities. “It was better to have no reinforcements at all than to bear the burden of more sick men,” Ms Fenn remarks. In no time, smallpox had also erupted in Mexico city and up along the north-west Pacific coast, showing that a vast web of human contact spanned the American continent well before Meriwether Lewis and William Clark made their famous journey to the Pacific in 1804.

George Washington, who was himself an early victim of the disease, eventually took charge of the continental army. He reversed the decision on inoculation, making immunisation compulsory, which helped the colonists win the war of independence. Today few people under the age of 30 have been vaccinated against smallpox. The virus spreads far more quickly than anthrax. For a real sense of what smallpox can do to a dense population with little or no immunity to the disease, “Pox Americana” will send shivers down your spine.

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Science and history of colour

Open your eyes

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JUST saying the names sounds like making a spell: verdigris, orpiment, realgar, madder, cochineal, giallorino and Egyptian frit. Colours and pigments have fascinated people throughout history, and with “Bright Earth”, Philip Ball, a science writer, brings the mysterious subject of colour wonderfully alive in an entertaining and informative book.

Bright Earth: The Invention of Colour
By Philip Ball

Viking; £18.99.

Buy it at
Amazon.com
Amazon.co.uk

If you have a theoretical turn of mind, you can worry yourself blue about what colours are. The world we see is full of them, but the world of physics, our ultimate arbiter on the nature of things, is made up strictly of colourless fields and particles. This conflict, which continues to vex the cleverest philosophers, is old and deep. Mr Ball, a physicist by training, notes simply that the problem is there, and passes quickly to what scientists can tell us about the generation of colour.

It arises from light waves in the visible band of the electromagnetic spectrum, the segment with wavelengths of 400 billionths of a metre at the blue end to 700 billionths at the red. Remarkably, the processes that cause colour vary radically in, for example, flames, water, various crystal, plants, metals and rainbows.

The physical production of colour phenomena is one thing. Their perception is another. Mr Ball next treats us to a brisk description of the human eye (remember rods and cones from school biology?), an explanation of why Newton was right and Goethe wrong about the composite character of white light, and an account of the 19th-century regimentation of the continuous colour spectrum by means of colour wheels and other classifying devices.

The real fun begins with paint, as Mr Ball describes in rich detail the development of artists' colours from medieval to modern times. Pigment has always been closely tied up with the business of dyeing and with practical uses for ordinary paint. But it is the expressive power of paint, especially oil paint, as an artist's medium that really gets Mr Ball going.

Medieval artists knew that mixing hues freely would produce grey mud (this is what threw Goethe off). By the 16th century, oil bases and, later, a growing understanding of colour allowed for ever subtler combinations. Yet even the great Venetian colourists were prey to pigments' tricks: vermilion reds that blacken and ultramarine skies that fade. Landscape painters struggled with treacherous greens that turn brown—and with the irksome fact that brown itself is not a natural hue (try finding it in a rainbow). Modern chemistry and industry came to the rescue in the 19th century, as stabler anilines, alizarins, azos and phthalos were added to palettes—from another novelty, metal tubes. Medievalising pre-Raphaelites and back-to-nature Impressionists seized alike on these manufactured pigments. At the same time, colour printing (subtler, it turns out, than computer graphics) came into its own.

All of these things and more are described in a straightforward style that keeps pages turning without making things artificially light. Mr Ball ends with the resin-based, acrylic and other smooth paints used by big-name contemporary artists. To readers who love painting but aren't painters themselves, “Bright Earth” should be, quite literally, an eye-opener.

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New fiction

Toaster-tossing and other losses

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THOUGH widely acclaimed in his native Australia, Murray Bail is best known in Britain and America as the author of “Eucalyptus”, an enchanting novel about love and gum trees, which appeared in 1999. Mr Bail is also an accomplished short-story writer. “Camouflage” is a slim volume of three stories, gathered together for the first time for non-Australian readers. Each is concerned with loss or change—sometimes dramatic, sometimes a slow, barely perceptible seeping away.

Camouflage
By Murray Bail

Harvill; £10.

Buy it at
Amazon.com
Amazon.co.uk

The title story is set during the second world war. A would-be recitalist who now tunes pianos is drafted into the army. Stationed in a remote corner of Australia's Northern Territory, he paints military aircraft hangars in camouflage colours. Silently and with complete equanimity, he comes to terms with his failing marriage and his own eerily detached personality.

“The Seduction of My Sister” starts out as straightforward domestic realism, then segues into a weirdly beautiful fantasy. Two teenage boys amuse themselves with an unusual after-hours game of catch. The first boy hurls old 78 records over the top of a garage; on the other side, the second boy does his best to field the discs as they whizz down through the night sky. The first boy's sister stands guard and raises the alarm if she sees traffic or a pedestrian coming. When all the records have been broken, the garage is ransacked for other projectiles. A stuffed fox, a toaster, a birdcage, a card table, an ironing board—all are sent arcing over the garage. By subtle degrees, Mr Bail makes it clear that it's not just the nature of the objects being sent over that is changing: the relationship between the three children is changing too.

“The Drover's Wife” takes its title from a well-known outback image in a painting by Russell Drysdale: in the foreground looms a big-framed, homely woman, with a bag in one hand; behind her, at some remove, a drover attends to his horse. Mr Bail's narrator is an abandoned husband who, as the story opens, insists calmly but firmly that the woman in the Drysdale painting “is not ‘The Drover's Wife'. She is my wife.”

The forthcoming American collection from Farrar, Straus includes 11 other stories, a delightful bonus, though the Harvill book has the three best. For those who haven't encountered Mr Bail's work before, “Camouflage”, in either edition, will be an excellent introduction. Meticulously pared down, his wonderfully imaginative stories have a resonance well beyond their modest proportions.

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Ideology of hotels

Iced water and the cold war

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THE success of Conrad Hilton's hotel company, the architecture of its buildings and their influence on urban landscape in the 1950s and 1960s were all closely connected with the politics of the cold war. So Annabel Jane Wharton tells us in this remarkable and provocative excursion into architectural and cultural history. She takes as exhibit A the Hiltons built between 1955 and 1969 in Athens, Cairo and Istanbul, but also brings in other cities, including Jerusalem and Tel Aviv.

Building the Cold War: Hilton International Hotels and Modern Architecture
By Annabel Jane Wharton

University of Chicago Press; $45 and £28.50
University of Chicago Press (July 2001); 263 pages; $45 and £28.50

Buy it at
Amazon.com
Amazon.co.uk
Amazon.com
Amazon.co.uk

Hiltons were designed in the American-modern style developed from pioneering European ideas by the New York architectural partnership of Skidmore, Owings and Merrill. They had air-conditioning, shopping arcades where there was no haggling, and restaurants serving American food. Glass-walled lobbies opened on to historic cityscapes that allowed guests an anxiety-free feeling of participation in a foreign world.

Hilton founded his company in 1946, just as America's long contest with the Soviet Union began, and he was an outspoken cold warrior from the start. The most effective single element in the global campaign against communism, he believed, was the promise of American ease and material plenty, open (more or less) to all. His hotels were designed so as to make that promise clear to as many people across the world as possible. Hilton rooms were standardised in size and layout. They each had a balcony, a spectacular view, iced water on tap and a direct-dial telephone. The Istanbul Hilton, on top of a hill in the newest, wealthiest part of the city, surrounded by parkland, offered a view of the Bosporus. In Cairo, the hotel faced the great pyramids, turning its back on the restless activities of the old city. From the Athens Hilton, guests could look out to the Acropolis. The formula succeeded less well in Berlin, Rome and Florence, where local hoteliers and preservationists fought the American-modern message with great ferocity and a fair measure of success.

The details—taken from company letters, interviews with former Hilton staff and secondary reading—are fascinating on their own. “Building the Cold War” is an impressive achievement. But what exactly is its overall argument? Though the domination of old cultures by new ones has occurred throughout history, and is occurring today, it works in subtle ways. Hilton may have promoted his enterprise by appeal to cold-war ideals. But was crusading, more than profit, what motivated him? And surely guests used his hotels, first and foremost, because they were comfortable and convenient. Hiltons did evoke security and American-led progress. But they were also hotels. Not everything is—or needs to work as—a symbol. Sometimes, iced water is just a cooling drink.

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Rebuilding New York

Brick by brick

Nov 29th 2001
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THE extraordinary story of the transformation of grungy Times Square into a safe area of family entertainment is told here by Lynne Sagalyn, the director of real-estate studies at Columbia University. She gives us a scholarly yet gripping enough account of the boldest urban redevelopment programmes in midtown Manhattan since the Rockefeller Centre was built in the 1930s. Though overshadowed in scale by the birth, death and possible rebirth of the World Trade Centre, the Times Square story deserves retelling for the light it sheds on the politics of big-city building.

Times Square Roulette: Remaking the City Icon
By Lynne B. Sagalyn

MIT Press; $59.95 and £41.50

Buy it at
Amazon.com
Amazon.co.uk

New York's City Hall will hate Ms Sagalyn's destruction of certain myths. One is that it took only $75m of public investment to stimulate $2.5 billion of private investment. These figures hide tax abatements, sale of land below fair value and other off-budget subsidies to private developers of Times Square and West 42nd Street.

Disney was a big beneficiary. Its executives knew that the city needed an unassailable corporate presence to attract other investors. The city rejected Disney's opening bid to gate the area, enabling it to create and control its customary orderly, safe and resolutely cheerful environment. But the company got almost everything else it asked for. Ms Sagalyn calculates that the sweetheart deal Disney negotiated to restore the New Amsterdam theatre to its old glory committed it to spend no more than $3m, or 8% of the total cost. Directly or indirectly, taxpayers picked up most of the tab.

Ms Sagalyn also explodes the myth that the transformation of Times Square and West 42nd Street was started and finished during the mayoralty of Rudolph Giuliani. Such speedy miracles were possible in the 1940s and 1950s, the heyday of Robert Moses, New York's greatest public builder. But he did not have to contend with environmental impact statements, class-action lawsuits and such complex processes of approval, consultation and review.

The area's transformation was 20 years in the making, but the delays served New York well. Continuous litigation and public derision defeated the initial plan to create a white-collar office district. At its core were four skyscrapers designed by Philip Johnson and John Burgee. Monolithic and monotonous, they would have cowed the restored theatres offered as a sop to the city's arts lobby. Instead, the city has ended up with the best it could hope for: a thriving place for business by day and a pulsating place for pleasure at night.

The easier part of the project was to get developers to put up better office blocks in and near Times Square. The occupants of such buildings go home at night. It was much harder to persuade Disney and others in the family-entertainment industry to invest in West 42nd Street, but their presence was absolutely essential. Vice on the Deuce, as the strip was known, scared away night-time visitors—New Yorkers as well as out-of-towners and foreign tourists—and threatened to make the whole area, including Broadway, a no-go area after dark.

The new Times Square came with costs. Sleazy, bawdy, deviant old West 42nd Street was a symbol of liberal, socially tolerant New York. This is an ambivalent tolerance, in Ms Sagalyn's words, “part pure disgust, part hardened acceptance, part perverse pride”. But it is something to cherish all the same.

That said, the gains probably outweigh the losses. As much as any urban project in America, this one has silenced once-fashionable talk of inner cities as expendable anachronisms. It has restored the central city as a place of public entertainment—a place for going out, seeing others, being seen, courting a little danger and having fun. As the debate begins over how, or whether, to rebuild at Ground Zero, New Yorkers have one—publicly aided—success to reflect on as a testbed.

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Language arbiters

English as she is wrote

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From The Economist print edition

NO ONE work has so influenced the writing of everyday English since, at least, Johnson's dictionary. H.W. Fowler's “Dictionary of Modern English Usage” was first published in 1926. “A Guide” would have been a truer title. Seen as such, the book sold 60,000 copies in a year and was soon a classic (nay, “the” classic, says the current “Chicago Manual of Style”, its nearest American equivalent). It has sold well ever since; heavily and wisely altered, it recently went into a third edition.

The Warden of English: The Life of H.W. Fowler
By Jenny McMorris

Oxford University Press; $27.50 (October 2001) and £19.99 (July 2001)

Buy it at
Amazon.com
Amazon.co.uk

Yet it was a product of its time. Henry Fowler from 1882 to 1899 had taught at Sedbergh, a bleak English public school. And just as such schools had developed codes of conduct, respected even when disobeyed, so after centuries of disorder, had English. Educated people, all agreed, knew the language; let others (Fowler saw “budding journalists” as one target) learn from them. Fowler's book was a belated product: by 1926, James Joyce was about to stand English on its head. Yet the rules have survived and “Fowler” with them.

Because the educated knew that they knew, they felt free to disagree. Fowler did. The great Oxford English Dictionary fancied the spelling “alinement”. No, he said, and won. Nor was he a pedant: accepting real usage as his standard, he derided the pedant's fantasy that no sentence may end with a preposition. But, as he admitted in a celebrated dispute (in which he was wrong), he was a grammatical moraliser. To him, correct English mattered; and he had no doubt that such a thing existed.

As a man, he was just as stern, above all, with himself, and as sure of what was right. He had to quit Sedbergh because he would not prepare boys for confirmation in a religion which he suspected was false. In 1915, aged 57, he volunteered, with his brother Frank, for an oldies' battalion and did his best to get posted to France. The two got there; indeed, briefly, to the front line, though they were soon sent back to menial duties at base. It was crazy. Frank, perhaps tubercular already, died of it. Henry was deeply grieved. But did he learn the crude lesson of looking after number one? Oxford University Press grossly underpaid his years of toil, though it pressed modest bonuses upon him. Typically, when it offered £5 for a small piece of work, he called this ridiculous and asked for £2 instead.

Maybe the OUP is making belated amends: it is hard to see huge sales for this account of scholarly publishing and of what was, in most respects but the crucial one, an unremarkable life. Fowler's true memorial is his work and influence, not a biography—still less one whose otherwise commendable author persistently writes “might have” and “would have been” where the real world uses “will have” or “probably was”.

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Robert Altman

Party piece

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An old master on top form

KING of the Hollywood independents for more than 30 years, Robert Altman has turned for the first time to a quintessentially old-world subject in “Gosford Park”, a comedy-drama played out over a country-house weekend reminiscent of Jean Renoir's pre-war “La Règle du Jeu” and Ken Loach's “The Gamekeeper”. It is one of his best works, recalling the magisterial control of huge casts and multiple plot threads in his masterworks, “Nashville” (1975) and “Short Cuts” (1993).

Altman's generous angle on life

A perfect insider-outsider, Mr Altman seems in his films to draw about equally from movies and from life. He was born in 1925 in Kansas City, where he grew up, and went to Jesuit school, in its jazz heyday. A bomber pilot in the war and an engineering graduate afterwards, he has worked prolifically in film ever since, using the camera in endlessly inventive ways. He knows the genres of Hollywood backwards, and enjoys turning them inside out. He has made hits (“M*A*S*H”, 1970) and flops (“Popeye”, 1980). Detractors find his humour bitter or his lengths a bore. But nobody quarrels with his ability to create and people screen worlds—which is what he has again done so well in “Gosford Park”.

As he did in “A Wedding” (1978), Mr Altman focuses on a single event—a 1932 shooting party at a country house, to which family and high society are invited. There are 50 speaking parts, played by the cream of British acting, from Michael Gambon and Maggie Smith to Kristin Scott Thomas and Charles Dance. Mirroring them are the below-stairs contingent, just as prodigally cast—Alan Bates, Helen Mirren, Emily Watson, Richard E. Grant, Derek Jacobi and many more. There is not a weak performance. The fun of the film lies in Mr Altman's intuitive grasp of interwar manners and class distinctions. The script is by a British actor, Julian Fellowes, and the director never misses a social trick.

As Joseph Losey did in “The Servant”, an American isolates the cruel rigidity of class better perhaps than the British would themselves. In a telling scene, the servants finally eat after attending to the upper crust. Alan Bates, as the butler, places them at table in the same social ranking as their individual lords and masters.

There are uncertainties in the film, however, elements that at first seem out of true until it is revealed how these, too, fit in. The only foreign guest is Bob Balaban's small-time Hollywood movie producer, whose forte is Charlie Chan detective thrillers (a pre-echo of the route “Gosford Park” will later take). His valet (Ryan Phillippe) has an over-the-top Scottish accent unrecognisable even to Scots. Explaining his role would give the game away.

His nonchalance is matched by Clive Owen as Charles Dance's valet. While the other British servants are deferential, his arrogance nears insubordination. How does he get away with it? What is his motive? And why do the cook (Eileen Atkins) and the housekeeper (Helen Mirren) resemble each other? All three are

related in ways that shed new light on what goes on at Gosford Park.

Mr Altman keeps the party moving with his stylistic trademark, a prowling CinemaScope camera, enabling one strand to merge into another and take the narrative almost imperceptibly in another direction. Gliding through the film is Jeremy Northam, as playwright, songsmith and matinée idol Ivor Novello. He is a kind of chorus, whose songs underscore the theme. (Mr Northam's beguiling light tenor suggests that he could, if he'd wanted, have had a different career.)

“Gosford Park” is both a social satire and, odd as it sounds, a murder mystery in the style of Agatha Christie. Stephen Fry (half Poirot, half Hulot) plays a bumbling detective who misses the clues. For Kristin Scott Thomas, this fault is less grave than his adding tea to milk, not milk to tea.

Surprisingly, this coda fits well with the main theme. A murder takes place, but as investigations proceed, it becomes clear that to these weekend guests, the whodunit is irrelevant. The killer is never caught (though the audience finds out who it is) and the guests depart, to the accompaniment of one last Ivor Novello song, only momentarily foxed by an intrusion of violence from a world they regard as quite separate from theirs.

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About sponsorship

Rosemary Brown

Nov 29th 2001
From The Economist print edition

Rosemary Isabel Brown, a musical psychic, died on November 16th, aged 85

Universal Photo

WRITERS about Rosemary Brown have tended to be cautious over her accomplishments. She claimed to have been in touch with Beethoven, Liszt, Chopin and some 20 other composers who had employed her as their contact on earth to receive their latest compositions.

Many people profess to be psychic, and some make great claims for their discipline. A debate is currently being conducted on the Internet about whether globalisation is being driven by “psychic energy”. But such matters, however intriguing, do not usually occupy the public stage. The psychic world tends to be a private one. What is particularly interesting about Mrs Brown is that she suddenly became famous in her native Britain and in the United States.

She made her public debut in a BBC television programme in April 1969. Her item was a short one, but it was noticed by several newspapers. Either Mrs Brown, a school dinner-lady from Balham, a London suburb, was a phenomenon, or, an equally promising story, the BBC had been taken in. It transpired that the BBC had not been taken in, but had been as baffled by the experience of Mrs Brown as were the reporters who increasingly came to knock at her door. How was it that a woman apparently of little musical ability had one day sat at a piano and had begun to play Chopin with ease, and Chopin music that no one had heard before?

As subsequently became clear, it wasn't quite like that. Rosemary Brown had been interested in music as long as she could remember. She had learnt the piano as a child and had hoped to be a dancer. She had long known she was psychic. She remembered having had a chat with Franz Liszt when she was seven. He had always kept in touch and sometimes went shopping with her. It was true that when times were hard Mrs Brown had worked in a school kitchen, but she had had a more dignified job in the Post Office. Some musical friends had taken an interest in her contacts with dead composers and had recorded some of the music she had received. That was how she came to be taken up by the BBC.

All this helped to make Mrs Brown a more believable person, and created a public ever eager to know more about her.

No sex in heaven

“The undiscovered country, from whose bourn no traveller returns” is a worry for many people other than Hamlet. Members of the established faiths have been told what awaits them after death, but millions of others are unsure. They listened with interest to what Rosemary Brown had to say when she appeared regularly on television in Britain and the United States, including a spot on “The Johnny Carson Show”. In heaven, she said, there was no sex; “the earthy side of our being has been left behind”. There was though, oddly, an interest in fashion. Clara Schumann was very dressy. Everyone was well. Beethoven was no longer deaf. There were no quarrels. Everything was in harmony. That didn't sound too bad. But was Mrs Brown making it all up? Was the music she said she was receiving any good? That had to be the test.

In the 1970s many music experts perused the scores that Mrs Brown had painstakingly taken down. Some were enthusiastic. Leonard Bernstein said he would “buy” the Rachmaninov. Peter Katin, an

outstanding interpreter of Chopin, was happy to record many of the piano works. Most of the experts were unsure. They were impressed by the sincerity of Mrs Brown who seemed to have no interest in profiting materially from her fame. They liked much of the music but were bothered that it was not outstanding, not the work of genius.

On the other hand the music seemed too good to have been composed by an amateur, however enthusiastic. The compositions suggested a professional hand. Nor were the pieces pastiches. One critic noted the “advanced harmonies” of a Liszt piece. A Hungarian writer was particularly pleased that his country's most celebrated composer was still in form. Mrs Brown was not perturbed by the controversy. She said that her composer friends were simply demonstrating that there was life after death. In her book “Unfinished Symphonies” she sought to explain the mysterious nature of music by quoting a message she said she had received from Chopin.

> Great music is something that is really born in the spirit and is reproduced, perhaps very badly, in your world.

A heavenly helping hand has often been acknowledged by otherwise down-to-earth composers. Mozart, for one, was baffled where his marvellous music came from. However, psychiatrists who were asked for an opinion about Mrs Brown's music said that it had come from her own mind. They constructed a plausible picture of a talented woman who, through childhood poverty, had been deprived of a musical career and had returned to music after her husband had died. Her psychic experiences they ascribed to hysteria, using the term in its medical sense, of dissociation. Since the Enlightenment, religious visionaries of all kinds have often been called hysterics. Joan of Arc, Theresa of Avila: the list is long. Mrs Brown was in distinguished company.

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Overview

Nov 29th 2001
From The Economist print edition

Hopes for an upturn in the **American economy** received a blow as the Conference Board's index of consumer confidence fell to 82.2 in November, from 85.3 in October. The decline marks the index's fifth monthly drop in a row. Most economists had been expecting the indicator to rise in November. Consumers' worries over labour-market conditions played a big role in the decline, with 23.0% of those surveyed saying that jobs were “hard to get”, up from 20.6% in October. Optimists had been buoyed earlier in the month by rising retail sales and a small increase in the University of Michigan's consumer-confidence index; however, that survey does not take employment conditions into account.

Sales of existing American homes rose by 5.5% in October, after falling in the wake of the September 11th terrorist attacks.

The Fed revised its industrial production figures for the period from January 1992 to October 2001; the new figures show that industrial production has fallen for only three consecutive months to October, rather than the 13 months originally reported.

In the **euro area**, the M3 measure of money supply grew at an annual rate of 7.4% in October, up from 6.9% in September. In the third quarter, **France's** GDP grew by 0.5%, a larger than expected gain. **Germany's** consumer-price inflation slowed from an annual rate of 2.0% in October to 1.7% in November, its lowest rate since May 2000, thanks to falling oil prices. Consumer confidence in **Italy** fell slightly as the ISAE index declined to 121.5 in November from 124.1 in October. **Belgium's** GDP rose by 0.9% in the year to the third quarter.

In **Sweden**, producer prices rose by 0.2% in October, making a year-on-year increase of only 0.5%. Sweden's producer prices have slowed since last year as a result of the global economic downturn, which has hit the country's high-tech exports especially hard. Retail sales in **Norway** rose by a vigorous 0.6% in October.

Japan's industrial output continued its long decline in October, falling by 0.3% to its lowest level in more than 13 years.

Canada's central bank cut its core overnight interest rate from 2.75% to 2.25%, its lowest level in 41 years. Canadian workers' wages rose by 2.3% in the year to September, a fall of 0.3% in real terms.

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Output, demand and jobs

Nov 29th 2001
From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2001	2002	latest	latest	latest	year ago
Australia	+ 3.6	+ 1.4 Q2	+ 2.1	+ 3.1	– 0.4 Q2	+ 5.8 Q3	7.1 Oct	6.0
Austria	+ 0.2	+ 1.2 Q2	+ 1.5	+ 1.3	+ 1.6 Aug	– 1.1 Jul	3.9 Sep	3.6
Belgium	– 1.2	+ 0.9 Q3	+ 1.4	+ 1.4	– 2.3 Sep*	+ 2.8 Aug	11.7 Sep*	11.5
Britain	+ 2.1	+ 2.1 Q3	+ 2.2	+ 1.8	– 3.0 Sep	+ 5.7 Oct	5.1 Sep†	5.4
Canada	+ 0.4	+ 2.1 Q2	+ 1.5	+ 1.5	– 3.2 Aug**	+ 3.5 Jun	7.3 Oct	6.9
Denmark	+ 2.3	+ 1.3 Q2	+ 1.2	+ 1.5	– 3.2 Sep	– 0.5 Aug	5.0 Sep	5.5
France	+ 1.9	+ 2.0 Q3	+ 1.9	+ 1.3	+ 1.0 Sep	– 1.2 Sep	8.9 Sep	9.4
Germany	– 0.6	+ 0.3 Q3	+ 0.7	+ 0.9	– 2.6 Sep	– 2.1 Sep	9.5 Oct††	9.3
Italy	+ 0.6	+ 1.9 Q3	+ 1.8	+ 1.2	– 4.3 Sep	– 2.1 Sep	9.4 Jul	10.5
Japan	– 2.9	– 0.7 Q2	– 0.6	– 0.5	–11.9 Oct	– 2.5 Sep	5.3 Sep	4.7
Netherlands	– 1.4	+ 0.4 Q3	+ 1.3	+ 1.4	– 2.2 Sep	+ 2.3 Aug	2.0 Oct§	2.6
Spain	+ 1.9	+ 2.9 Q2	+ 2.7	+ 2.0	– 2.5 Sep	na	13.0 Sep	13.8
Sweden	+ 0.8	+ 1.1 Q2	+ 1.7	+ 1.9	– 2.4 Sep	+ 4.3 Sep	4.0 Oct*	4.0
Switzerland	+ 1.7	+ 2.0 Q2	+ 1.5	+ 1.2	+ 4.2 Q2*	+ 1.7 Sep	1.9 Oct*	1.7
United States	– 0.4	+ 0.8 Q3	+ 1.0	+ 0.8	– 6.4 Oct	+ 0.9 Sep	5.4 Oct	3.9
Euro area	+ 0.4	+ 1.7 Q2	+ 1.5	+ 1.2	– 0.6 Sep	+ 1.8 Aug	8.3 Sep	8.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	– 6.7	+ 0.4 Q2	na	na	– 3.5 Sep	+ 3.8 Aug	8.9 Oct*	8.9
Greece	+ 2.8	+ 4.9 Q2	na	na	+ 0.3 Aug*	+ 8.3 Jul	na	na
Iceland	na	+ 3.62000	na	na	+ 2.5 2000	na	1.2 Sep	1.2
Ireland	na	+ 9.2 Q2	na	na	+ 5.2 Sep*	+ 1.4 Sep	3.9 Oct	3.7
Luxembourg	na	+ 8.52000	na	na	– 3.0 Aug*	+ 9.5 Aug	2.5 Sep	2.6
New Zealand	+ 7.4	+ 2.8 Q2	na	na	+ 3.5 Q2*	+ 6.3 Q3	5.2 Q3	5.8
Norway	+ 0.5	+ 1.4 Q2	na	na	+ 1.9 Sep*	+ 3.7 Oct	3.6 Q3	3.5
Portugal	+ 1.6	+ 2.5 Q2	na	na	– 0.2 Sep*	+ 3.9 Sep	4.0 Q3	4.0

*Not seasonally adjusted. †Jul-Sep; claimant count rate 3.2% in Oct. §Aug-Oct. **New series. ††EU harmonised rate 8.0% in Oct.

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Prices and wages

Nov 29th 2001
From The Economist print edition

% change at annual rate

	Consumer prices* latest		Consumer prices* year ago	The Economist poll consumer prices forecast 2001	The Economist poll consumer prices forecast 2002	Producer prices* latest		Producer prices* year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 2.5	Q3	+ 6.1	+ 4.2	+ 2.5	+ 2.4	Q3	+ 7.2	+ 3.6	Q3	+ 6.5
Austria	+ 2.6	Oct	+ 2.8	+ 2.5	+ 1.5	– 0.5	Oct	+ 6.0	+ 2.9	Sep	+ 1.9
Belgium	+ 2.4	Oct	+ 3.0	+ 2.5	+ 1.6	– 0.2	Sep	+10.8	+ 3.7	Q3	+ 1.4
Britain	+ 1.6	Oct	+ 3.1	+ 2.1	+ 2.2	– 0.6	Oct	+ 2.7	+ 4.4	Sep	+ 4.1
Canada	+ 1.9	Oct	+ 2.8	+ 2.8	+ 1.9	+ 0.5	Sep	+ 4.0	+ 2.3	Sep	+ 3.5
Denmark	+ 2.2	Oct	+ 2.7	+ 2.3	+ 2.0	– 0.3	Oct	+ 6.9	+ 4.7	Q2	+ 3.3
France	+ 1.8	Oct	+ 1.9	+ 1.8	+ 1.2	– 0.2	Sep	+ 6.6	+ 4.2	Q2	+ 5.4
Germany	+ 1.7	Nov	+ 2.4	+ 2.5	+ 1.3	– 1.1	Oct	+ 7.4	+ 2.3	Sep	+ 2.1
Italy	+ 2.4	Nov	+ 2.7	+ 2.7	+ 1.7	+ 0.4	Sep	+ 6.7	+ 2.4	Sep*	+ 1.7
Japan	– 0.8	Sep	– 0.8	– 0.7	– 0.7	– 0.5	Oct	+ 0.3	– 0.5	Sep*	+ 1.5
Netherlands	+ 4.3	Oct	+ 3.1	+ 4.7	+ 2.2	+ 0.5	Sep	+ 8.8	+ 4.1	Sep	+ 3.4
Spain	+ 3.0	Oct	+ 4.0	+ 3.7	+ 2.3	+ 0.6	Sep	+ 5.5	+ 2.9	Q2†	na
Sweden	+ 2.7	Oct	+ 1.4	+ 2.4	+ 1.9	+ 0.5	Oct	+ 4.6	+ 3.2	Aug*	+ 3.3
Switzerland	+ 0.3	Nov	+ 1.9	+ 1.3	+ 1.1	– 1.4	Oct	+ 2.6	+ 1.3	2000	+ 0.3
United States	+ 2.1	Oct	+ 3.4	+ 3.0	+ 1.8	– 0.4	Oct	+ 3.7	+ 4.1	Oct	+ 3.9
Euro area	+ 2.4	Oct	+ 2.7	+ 2.6	+ 1.6	+ 0.7	Sep	+ 6.3	+ 3.0	Q2	+ 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.9	Oct	+ 4.1	na	na	– 3.5	Oct	+ 9.6	+ 4.5	Q3*	+ 4.9
Greece	+ 2.8	Oct	+ 4.0	na	na	+ 1.7	Sep	+ 9.2	na		na
Iceland	+ 8.1	Nov	+ 4.6	na	na	+ 6.8	Nov	+ 3.9	+ 9.1	Oct	+ 7.8
Ireland	+ 4.3	Oct	+ 6.8	na	na	– 0.8	Oct	+ 7.7	+ 9.1	Q2*	+ 7.0
Luxembourg	+ 2.3	Oct	+ 3.4	na	na	+ 0.9	Sep	+ 6.1	+ 3.4	Aug*	+ 7.0
New Zealand	+ 2.4	Q3	+ 3.0	na	na	+ 8.1	Q2	+ 5.9	+ 2.0	Q3	+ 1.5
Norway	+ 2.2	Oct	+ 3.1	na	na	–19.1	Oct	+ 7.4	+ 4.4	Q2*	+ 3.9
Portugal	+ 4.1	Oct	+ 3.5	na	na	– 4.9	Oct	+16.9	+ 2.4	Apr*	na

*Not seasonally adjusted. †New series.

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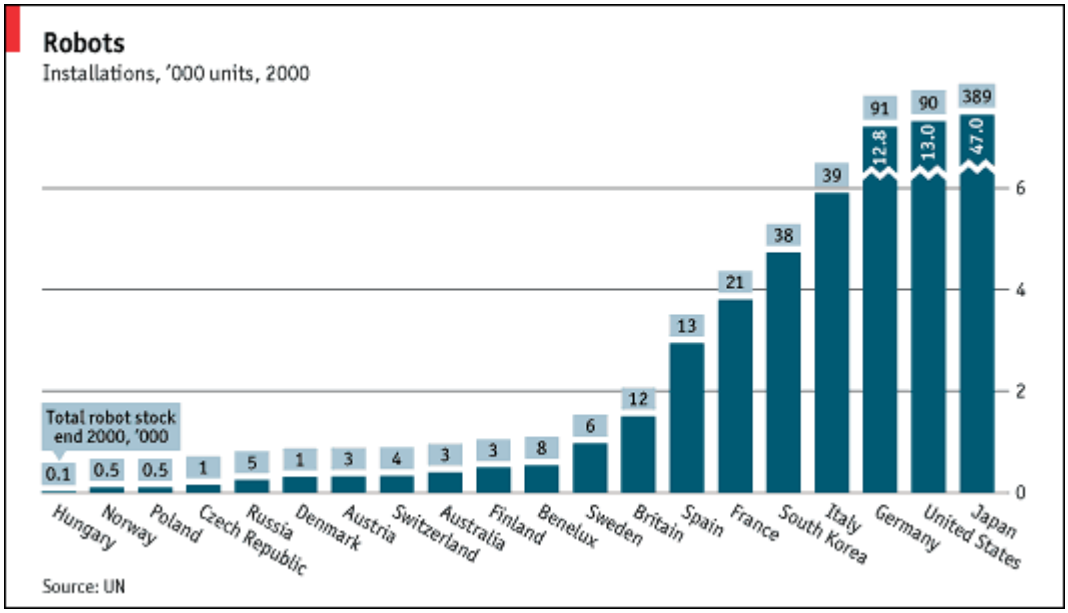
Robots

Nov 29th 2001
From The Economist print edition



The clear leader in using industrial robots is Japan, which accounts for over half of all units in the world. Investment in robots worldwide increased markedly last year, with almost 100,000 new units installed, raising the total stock of robots to 750,000 at the end of 2000. But the global downturn has led to a sharp reduction in investments in North America and Asia in the first half of 2001.

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Money and interest rates

Nov 29th 2001
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Nov 28th 2001)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+19.1	+ 9.9	Sep	4.31	6.29	4.44	5.67	5.85	6.85
Britain	+ 6.9	+ 8.1	Oct	3.91	6.00	4.41	4.68	4.90	5.94
Canada	+11.2	+ 4.2	Oct	2.08	5.63	3.37	5.35	5.55	7.18
Denmark	+ 5.9	+ 4.0	Oct	3.75	5.55	4.04	4.78	5.31	7.04
Japan	+11.7	+ 3.6	Oct	0.02	0.50	0.07	1.34	1.66	1.46
Sweden	+ 7.3	+ 4.9	Oct	3.74	4.11	4.14	5.04	4.97	5.20
Switzerland	+ 1.8	+ 4.2	Oct	2.10	3.52	2.52	3.15	3.73	4.24
United States	+ 5.6	+13.0	Oct	2.05	6.65	3.06	4.95	5.55	6.75
Euro area†	+ 5.3	+ 7.4	Oct	3.38	5.09	3.52	4.59	5.00	5.23

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.37%, Japan No.235 1.36%. Central bank rates: US fed funds 2.00%, ECB refinancing 3.25%, BOJ overnight call 0.002%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, OM Fixed Income Exchange, UBS Warburg, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Nov 29th 2001
From The Economist print edition

1995=100

	Nov 20th	Nov 27th*	% change on one month	% change on one year
Dollar index				
All items	65.5	65.9	+ 4.7	– 9.0
Food	68.1	67.9	+ 2.9	– 4.5
Industrials				
All	61.9	63.2	+ 7.5	–14.8
Nfa†	57.4	57.3	+ 2.8	–16.9
Metals	65.7	68.2	+11.1	–13.3
Sterling index				
All items	72.9	73.5	+ 7.8	– 8.7
Euro index				
All items	97.5	98.3	+ 7.9	–11.8
Yen index				
All items	85.5	86.9	+ 6.7	+ 2.4
Gold				
$ per oz	273.20	273.45	– 2.4	+ 1.6
West Texas Intermediate				
$ per barrel	18.95	19.24	–11.9	–43.5

* Provisional. † Non-food agriculturals.

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Stockmarkets

Nov 29th 2001
From The Economist print edition

Market indices

	Nov 28th	2001 high	2001 low	% change on one week	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,290.7	3,425.2	2,867.4	+ 0.6	– 3.9	+ 4.3	– 2.4
Austria (ATX)	1,096.4	1,245.8	1,014.3	+ 0.6	–36.9	+ 2.2	– 3.6
Belgium (Bel 20)	2,585.2	3,030.4	2,322.6	– 4.2	–29.8	–14.5	–19.3
Britain (FTSE 100)	5,205.2	6,334.5	4,433.7	– 2.0	–24.9	–16.3	–20.3
Canada (Toronto Composite)	7,358.2	9,348.4	6,513.1	+ 0.4	–35.4	–17.6	–22.0
Denmark (KBX)	218.7	294.3	197.8	– 1.0	–27.5	–17.4	–21.8
France (SBF 250)	2,876.4	3,820.2	2,335.3	– 2.0	–34.5	–23.7	–28.0
(CAC 40)	4,445.5	5,998.5	3,652.9	– 2.4	–35.8	–25.0	–29.2
Germany (Xetra DAX)	4,916.0	6,795.1	3,787.2	– 3.4	–39.0	–23.6	–27.9
Italy (BCI)	1,409.0	1,948.4	1,082.9	– 2.2	–35.4	–26.5	–30.6
Japan (Nikkei 225)	10,624.8	14,529.4	9,504.4	– 0.3	–72.7	–22.9	–28.6
(Topix)	1,053.3	1,441.0	863.4	– 0.5	–63.5	–17.9	–23.9
Netherlands (AEX)	489.5	642.3	396.2	– 1.8	–30.2	–23.2	–27.5
Spain (Madrid SE)	824.4	963.9	648.6	– 0.6	–28.1	– 6.4	–11.7
Sweden (Affarsvarlden Gen)	226.7	293.1	177.5	+ 1.4	–43.4	–18.4	–27.6
Switzerland (Swiss Market)	6,286.3	8,135.4	5,110.2	– 3.2	–25.3	–22.7	–24.0
United States (DJIA)	9,711.9	11,337.9	8,235.8	– 1.2	–17.2	–10.0	–10.0
(S&P 500)	1,128.5	1,373.7	965.8	– 0.7	–26.1	–14.5	–14.5
(Nasdaq Comp)	1,888.0	2,859.2	1,423.2	+ 0.7	–62.6	–23.6	–23.6
Europe (FTSE Eurotop 300)*	1,225.0	1,545.5	998.9	– 2.3	–28.2	–20.1	–24.6
Euro area (FTSE Ebloc 100)*	1,065.5	1,404.1	843.6	– 2.5	–31.3	–23.5	–27.8
World (MSCI)†	987.2	1,249.2	856.6	– 0.8	–31.9	na	–19.2
World bond market (Salomon)‡	447.1	461.7	420.6	+ 0.5	– 2.8	na	+ 0.7

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Schroder Salomon Smith Barney World Government Bond Index, total return, in dollar terms.

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Trade, exchange rates and budgets

Nov 29th 2001
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2001	Current account The Economist poll % of GDP, forecast 2002	Exchange rate trade-weighted† Nov 28th	Exchange rate trade-weighted† year ago	Currency units per $ Nov 28th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2001‡
Australia	+ 2.3 Sep	− 8.5 Q3	− 2.8	− 3.4	73.1	71.8	1.92	1.91	2.74	1.70	1.56	0.1
Austria	− 5.0 Aug	− 4.3 Sep	− 2.6	− 2.5	100.0	99.2	15.5	16.0	22.1	13.8	12.6	nil
Belgium	+ 11.0 Sep	+ 8.9 Jun	+ 4.2	+ 4.4	98.8	97.7	45.5	46.9	64.8	40.3	37.0	nil
Britain	− 47.1 Sep	− 19.2 Q2	− 1.9	− 2.3	105.5	106.8	0.70	0.70	–	0.62	0.57	1.1
Canada	+ 44.4 Sep	+ 25.5 Q2	+ 2.9	+ 1.9	75.9	77.8	1.59	1.54	2.26	1.40	1.29	2.8
Denmark	+ 7.1 Sep	+ 5.2 Sep	+ 2.0	+ 1.9	102.3	99.9	8.40	8.68	12.0	7.44	6.82	2.0
France	− 0.8 Sep	+ 21.8 Sep	+ 1.5	+ 1.6	101.4	100.2	7.40	7.63	10.5	6.56	6.01	-1.5
Germany	+ 66.1 Sep	− 11.6 Sep	− 1.1	− 0.7	98.3	96.7	2.21	2.28	3.14	1.96	1.79	-2.5
Italy	+ 3.5 Sep	− 3.6 Aug	− 0.2	− 0.1	72.3	71.5	2,185	2,252	3,111	1,936	1,774	-1.4
Japan	+ 77.5 Sep	+ 89.4 Sep	+ 2.0	+ 1.8	137.4	154.0	123	111	175	109	–	-6.4
Netherlands	+ 18.3 Sep	+ 11.1 Q3	+ 4.1	+ 4.3	97.8	96.4	2.49	2.56	3.54	2.20	2.02	1.1
Spain	− 38.2 Aug	− 15.4 Aug	− 2.6	− 2.6	74.1	73.3	188	194	267	166	152	nil
Sweden	+ 12.6 Oct	+ 6.3 Sep	+ 2.1	+ 2.2	73.9	79.2	10.64	10.11	15.1	9.43	8.64	3.8
Switzerland	nil Oct	+ 27.9 Q2	+10.7	+10.9	112.9	107.3	1.65	1.76	2.35	1.46	1.34	na
United States	−444.5 Sep	−449.9 Q2	− 4.1	− 3.9	120.2	116.7	–	–	1.42	0.89	0.81	0.6
Euro area	+ 18.8 Sep	− 35.9 Sep	− 0.3	− 0.1	78.3	76.3	1.13	1.16	1.61	–	0.92	-1.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 12.9 Sep	+ 8.0 Sep	na	na	78.3	76.3	6.71	6.91	9.55	5.95	5.45	3.7
Greece	− 7.4 Jun	− 7.3 Jun	na	na	57.4	56.7	385	396	548	341	313	0.2
Iceland	− 0.3 Sep	− 0.9 Q1	na	na	na	na	110	87.7	157	97.5	89.3	-0.2
Ireland	+ 31.4 Sep	− 1.5 Q2	na	na	87.2	85.4	0.89	0.92	1.27	0.79	0.72	3.2
Luxembourg	− 3.3 Aug	+ 1.2 Q2	na	na	98.8	97.7	45.5	46.9	64.8	40.3	36.9	5.3
New Zealand	+ 0.4 Sep	− 1.9 Q2	na	na	79.1	75.2	0.41	2.47	0.58	0.36	0.33	1.3
Norway	+ 26.9 Oct	+ 26.0 Aug	na	na	96.6	92.9	8.97	9.35	12.8	7.95	7.28	14.3
Portugal	− 13.9 Aug	− 9.1 Aug	na	na	89.3	88.3	226	233	322	200	183	-1.7

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.

Text refers only to the first 16 countries listed

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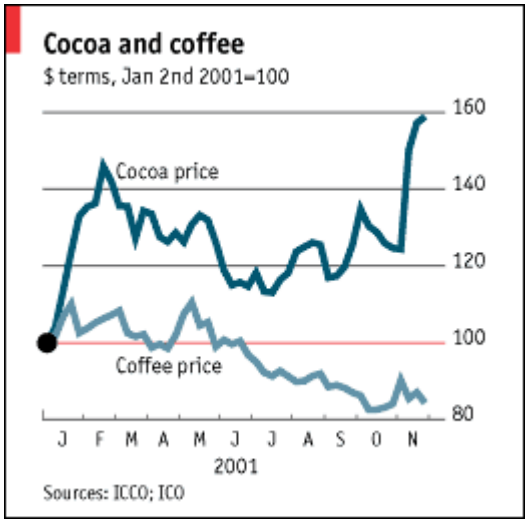
Cocoa and coffee

Nov 29th 2001
From The Economist print edition

Cocoa prices have risen by 30% over the past month, reaching a three-year high. Forecasts of a poor crop in Côte d'Ivoire, caused by disease and poor farm maintenance, have led some analysts to estimate that the country's production could drop by 200,000 tonnes in the year to September 2002. By contrast, coffee prices continue to sag, due to excess supply.



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Overview

Nov 29th 2001
From The Economist print edition

More signs emerged of economic weakness in South-East Asia. **Malaysia's** GDP fell by 1.3% in the year to the third quarter. In the **Philippines**, industrial production declined by 1.1% in the year to September. This was a modest setback compared with the 21.4% decline in industrial output in **Singapore** in the 12 months to October. Semiconductor producers have been hardest hit: their output has fallen by almost half.

South Africa's economy is also being battered by the global downturn. Growth slowed abruptly to only 0.1% in the year to the third quarter.

Growth slowed in **Chile** to 2.6% in the year to the third quarter.

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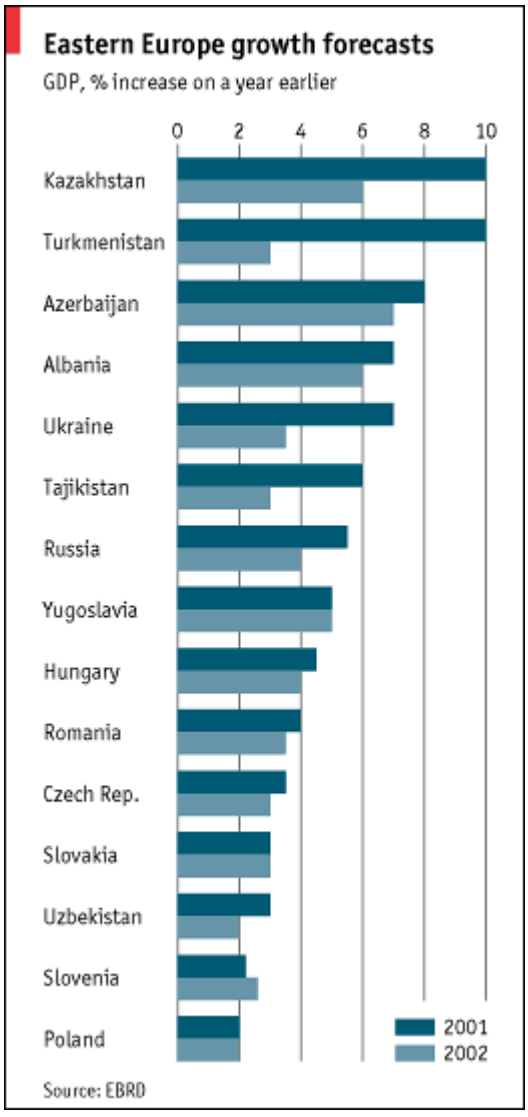
Eastern Europe growth forecasts

Nov 29th 2001
From The Economist print edition

Eastern Europe and the former Soviet Union enjoyed rapid economic growth in 2000. Growth has slowed in 2001 and looks likely to weaken further in 2002, says the European Bank for Reconstruction and Development. Central Europe and the Baltics are most exposed to the global slowdown. The former Soviet Union looks better insulated, but a fall in oil prices below $18-22 a barrel would be particularly painful for Russia.



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Economy

Nov 29th 2001
From The Economist print edition

	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.0	Q3	+ 8.8	Oct	+ 0.2	Oct	+18.6	Oct	+20.5	2000	193.2	Aug
Hong Kong	+ 0.5	Q2	– 0.1	Q2	– 1.2	Oct	–12.1	Oct	+ 8.2	Q2	113.1	Oct
India	+ 4.4	Q2	+ 1.6	Sep	+ 5.2	Sep	– 6.1	Sep	– 0.9	Q2	42.2	Oct
Indonesia	+ 3.5	Q3	+ 7.5	Q1	+12.5	Oct	+24.6	Sep	+ 6.8	Q1	27.8	Aug
Malaysia	– 1.3	Q3	– 9.7	Sep	+ 0.9	Oct	+15.4	Sep	+ 7.5	Q2	25.4	Sep
Philippines	+ 2.9	Q3	– 1.1	Sep	+ 5.4	Oct	+ 3.4	Sep	+ 5.1	Aug	12.2	Aug
Singapore	– 5.6	Q3	–21.4	Oct	+ 0.2	Oct	+ 4.2	Oct	+22.1	Q3	76.2	Oct
South Korea	+ 1.8	Q3	– 1.3	Oct	+ 3.6	Oct	+11.1	Oct	+10.3	Oct	100.0	Sep
Taiwan	– 4.2	Q3	– 6.7	Oct	+ 1.0	Oct	+14.1	Oct	+16.2	Q3	116.2	Oct
Thailand	+ 1.9	Q2	– 1.8	Sep	+ 1.4	Oct	+ 2.9	Oct	+ 6.4	Sep	31.9	Sep
Argentina	– 0.5	Q2	– 7.9	Oct	– 1.7	Oct	+ 4.1	Sep	– 8.4	Q2	20.6	Sep
Brazil	+ 0.8	Q2	– 1.9	Sep	+ 8.2	Oct	+ 0.7	Oct	–25.4	Oct	40.1	Sep
Chile	+ 2.6	Q3	+ 4.9	Oct	+ 3.4	Oct	+ 1.5	Oct	– 1.7	Q3	14.4	Sep
Colombia	+ 1.6	Q2	– 0.8	Sep	+ 8.0	Oct	+ 0.8	Sep	– 0.7	Q2	9.7	Sep
Mexico	– 1.6	Q3	– 5.4	Sep	+ 5.9	Oct	– 9.5	Oct	–16.6	Q3	42.8	Sep
Peru	+ 2.3	Sep	+ 0.7	Sep	+ 0.7	Oct	– 0.2	Sep	– 1.4	Q3	8.4	Sep
Venezuela	+ 2.8	Q3	+ 3.2	Aug	+12.3	Oct	+15.6	Q2‡	+ 8.8	Q3	9.0	Sep
Egypt	+ 6.5	2000†	+ 9.4	2000†	+ 2.1	Sep	– 8.8	Jul	nil	Q2	13.1	Jul
Israel	– 2.7	Q3	–15.4	Sep	+ 2.0	Oct	– 7.1	Oct	– 1.4	Q2	23.8	Oct
South Africa	+ 0.1	Q3	+ 0.5	Sep	+ 4.0	Oct	+ 4.6	Sep	+ 0.4	Q2	6.0	Sep
Turkey	– 9.3	Q2	– 9.2	Sep	+66.5	Oct	–15.8	Sep	– 1.2	Aug	19.0	Sep
Czech Republic	+ 3.9	Q2	+ 1.1	Sep	+ 4.4	Oct	– 3.2	Oct	– 2.7	Q2	14.7	Oct
Hungary	+ 4.0	Q2	– 4.4	Sep	+ 7.6	Oct	– 2.1	Oct	– 1.1	Sep	11.8	Oct
Poland	+ 0.9	Q2	+ 1.4	Oct	+ 4.0	Oct	– 9.6	Sep	– 6.0	Sep	28.0	Oct
Russia	+ 5.1	Q2	+ 5.1	Oct	+18.9	Oct	+56.7	Sep	+44.6	Q2	34.0	Oct
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+10.2	Jun	+ 2.9	Oct	– 1.2	Sep	+ 0.3	2001†	2.2	Sep
Saudi Arabia	+ 4.5	2000§	na		– 0.5	Sep	+50.9	2000	+15.6	2000	17.2	Sep

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series. § Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Nov 29th 2001
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Nov 28th		Dec 31st 2000	
	Nov 28th	year ago	Nov 28th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	11.8	na	1,810.3	+1.7	–17.4	–17.4
Hong Kong	7.80	7.80	11.1	2.09	11,066.2	– 1.0	–26.7	–26.7
India	48.0	46.9	68.3	6.71	3,294.1	+1.5	–17.1	–19.3
Indonesia	10,400	9,490	14,808	17.91	382.9	+0.2	– 8.0	–14.4
Malaysia	3.80	3.80	5.41	3.30	641.1	+1.3	– 5.7	– 5.7
Philippines	52.0	49.6	74.0	11.19	1,120.6	+8.4	–25.0	–27.8
Singapore	1.83	1.76	2.61	1.13	1,476.5	+0.8	–23.4	–27.5
South Korea	1,267	1,203	1,804	4.75	632.0	+2.7	+25.2	+25.0
Taiwan	34.4	33.0	49.0	2.60	4,447.6	– 1.9	– 6.2	– 9.8
Thailand	44.1	43.9	62.8	2.75	293.0	+0.6	+8.8	+7.1
Argentina	1.00	1.00	1.42	54.30	212.0	+3.3	–49.2	–49.2
Brazil	2.49	1.96	3.54	19.05	13,019.2	+1.8	–16.5	–34.6
Chile	676	580	963	5.25*	5,400.6	– 1.9	+10.9	– 5.9
Colombia	2,311	2,173	3,290	11.58	921.3	+0.5	na	na
Mexico	9.27	9.40	13.2	7.00	5,848.2	+3.1	+3.5	+7.2
Peru	3.44	3.53	4.9	3.09	1,179.4	+1.8	– 2.4	+0.2
Venezuela	746	697	1,062	14.86	6,258.0	– 0.6	– 7.9	–13.6
Egypt	4.27	3.78	6.08	8.05	5,081.2	– 0.4	–33.7	–39.6
Israel	4.23	4.10	6.03	3.91	396.6	+2.8	–19.8	–23.4
South Africa	9.87	7.78	14.1	9.06	9,258.1	– 1.0	+11.2	–14.7
Turkey	1,482,000	685,425	2,110,072	57.00	11,129.3	– 4.2	+17.9	–46.7
Czech Republic	37.6	40.3	53.5	5.06	393.4	– 2.4	–17.8	–17.7
Hungary	283	309	403	10.21	7,218.5	+0.8	– 8.0	– 8.2
Poland	4.06	4.50	5.78	13.07	14,214.5	– 0.1	–20.4	–19.0
Russia	29.9	27.9	42.6	25.00	224.3†	+2.7	+63.6	+56.5
EMF (MSCI)‡	1.00	1.00	1.42	na	295.1	+0.8	na	–11.6
EMBI+§	1.00	1.00	1.42	na	200.8	+0.7	na	– 0.6

*Inflation adjusted. †In $ terms. ‡Emerging Markets Free. §J.P. Morgan Chase's Emerging Markets Bond Index Plus.

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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